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**TRANSATLANTIC DISPUTES IN
COMPETITION POLICY:
VERSIONS OF LIBERALISM OR
MERCANTILISM V LIBERALISM**

GISLE TORHEIM

**DEPARTMENT OF POLITICAL SCIENCE
UNIVERSITY OF OSLO**

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Preface

Competition policy is important; important for states, for firms, and for you and me as consumers. Daily, one can read about it in the press: cartels are busted, monopolies broken up, and mergers worth billions of dollars are approved or blocked. Despite the occasional accusation that a decision is made based on narrow political interests, competition policy is largely seen as a matter of law and economics. This bias has also carried into academia, and political scientists have only recently begun to show an interest for what, in my opinion, should be seen as much as a policy issue as anything else. This thesis is a modest attempt to bring a broader perspective into the analysis.

I have not been alone in this effort. A first thanks goes to Helge Hveem, my supervisor, who introduced me to the field and has given me constructive feedback and support throughout this endeavour. Bent Sofus Tranøy, Sjur Kasa, Jeff Checkel, and Ketil Gjølme Andersen have all read (parts) of the thesis and deserve thanks for their comments and even more for being highly useful discussion partners.

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Fellow students and friends at TIK and at the Department of Political Science have shown me that frustration is normal and that postponements are typical – in addition to the fun we have had over lunch and dinner or on the football field. Special thanks to Niko Owe, who took over where the spelling and grammar checks were insufficient. Last, but not least, Sonja deserves my gratitude for her constructive advice, patience, and moral support, and for bearing up under another finishing phase after just having completed her own.

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Gisle Torheim

Chapter 1. Introduction

Each year, the competition authorities in the United States and in the European Union review hundreds of merger cases. Some only concern one of the jurisdictions; some affect both. In a large majority of the multi-jurisdictional cases, the authorities agree on whether a deal should be approved or blocked. In a few, however, they do not. The main purpose of this thesis is to explain *why* disagreement occurs.

Over the last quarter of a century, “free market competition” has to an ever increasing degree been cited as the solution to almost any economic challenge facing a society. At the same time, the state is viewed with much scepticism, and by some as the main threat to welfare creation. At a national level, privatisation and marketisation of public services and deregulation of private economic activity have constituted the doctrine of the day; internationally, liberalisation of politically imposed barriers to free trade has been on top of state leaders’ agendas. This is not to say that the development is uniform or that it cannot be reversed; it does, however, provide a rough description of what in this thesis will be called a liberal politico-economic paradigm.

It is too simplistic to assume that only government regulation and interference threaten the well-functioning of markets, however. Firms have strong incentives to undertake actions that reduce competition, as it will allow them to increase the price of their product and make a greater profit. This will be at the cost of the rest of society, which provides a rationale for and justifies state intervention to prevent or correct these actions. The term ‘competition policy’ encompasses the set of practices used to regulate the market, and typically includes provisions dealing with *structure* such as monopoly, dominance and mergers, as well as *behaviour*, including collusion, price fixing and predatory pricing. The responsibility to implement these practices is generally endowed with competition authorities.

This thesis will be concerned with one particular sub-set of competition policy, namely merger regulation. Mergers are an integral part of the competitive process and a large majority have positive or neutral effects on the performance of the market, while a few have negative consequences. With the increasing liberalisation, there has been a boost in the number of mergers undertaken world-wide: After an average

annual growth rate of 42 per cent since 1980, the total value of transactions reached USD 2.3 trillion in 1999 (UNCTAD 2000:106). A substantial share have an international dimension: about one quarter take place between firms with different nationalities (so-called cross-border mergers), both in terms of value and number of deals; in addition, “domestic” mergers may have significant effects on foreign markets if the parties to the transaction have affiliates abroad or engage in exports.

To single out the mergers that have anticompetitive effects, all proposed transactions over a certain size are scrutinised by the competition authorities and must gain their approval before completion. Those that have impact across borders are typically reviewed by the authorities in each jurisdiction that they concern. The majority of these multi-jurisdictional mergers affect the US and the European Union (the EU), due to their close economic relationship and the fact that many cross-border deals take place between firms from the two areas. In most cases, the outcomes of their merger reviews are consistent; on occasion, however, they are not, often leading to heated discussions on whose “fault” it is.

1.1 The Research Question and how to Approach it

A key question that arises from the observations above will take the centre stage in this thesis: *When reviewing the same merger, why do authorities in the US and the EU reach different outcomes?* A clarifying note should be made on the term “the same merger”. Some deals affect both the US and the EU, but in very different ways. The involved parties may, for example, be the two largest firms in the former but only have small shares on the European market. In such cases, one should expect outcomes to differ, and they are *per se* not the concern of this thesis. The above question thus only applies to mergers where the US and EU competition authorities define the affected markets identically.

To explain why outcomes differ between jurisdictions, one must examine why and how each outcome is reached in the first place. In the following chapters, it will be argued that this closely depends on whether competition policy is autonomous from the interference of societal interests or not. If it is, competition authorities will set the premises for outcomes. The task will then be one of inquiring into what ideas or

interests motivate the actions of the authorities and whether they differ between the US and the EU. If, on the other hand, competition policy is *not* autonomous, it becomes interesting to identify which societal groups are likely to be involved in a merger review, what their interests are, and how and to what extent they can be expected to get their will. In the end, it will be left to empirical analyses of merger cases to decide why outcomes are reached and, consequently, why they differ between the US and the EU.

Research on competition policy has, to a large extent, been dominated by scholars of law and economics (and the combination of the two, often known as the economic analysis of law, which is particularly developed in the US). This means that competition policy as a *policy* issue has gotten less attention than what it deserves, although lately, some interesting discussions have been offered from public policy and organisation theory perspectives (see Doern and Wilks 1996; Cini and McGowan 1998). The approach used here is one of (international) political economy. As should become evident in the following chapters, it will draw on and take advantage of the insights that have been developed within all the above-mentioned perspectives; they will, however, be tied together and interpreted in a broader political framework.

1.2 The Organisation of the Thesis

The rest of the thesis will be organised as follows. In *Chapter 2*, a theoretical and methodological framework for understanding merger case outcomes will be developed in three steps. Firstly, the dependent and independent variables will be defined and discussed separately. Secondly, two strands of explanations will be offered for linking them: one is idea-based; the other is interest-based. Under each, more specific theories of political economy will be presented and examined. Thirdly, the theoretical approaches will be operationalised. The chapter will be concluded with discussions on the selection of cases and the use and interpretation of sources. *Chapter 3* will offer a comparison of the US and EU competition regimes on several aspects: legal foundations for merger regulation; institutional build-up of the competition authorities; goals; and merger review procedures. Furthermore, cooperation between the authorities will be examined. Lastly, legal and institutional features that enable and

facilitate divergence from the formal rules and procedures will be discussed. *Chapter 4* presents two competing hypotheses responding to the research question of why outcomes differ between the jurisdictions. They will be followed by some expectations derived from the discussions of the two previous chapters. In *Chapters 5* and *6*, the (proposed) mergers between Boeing and McDonnell Douglas and between General Electric and Honeywell, respectively, will be studied in detail according to the framework developed in the previous chapters. In both cases, the US and the EU reached different outcomes as to whether the mergers should be approved or not. As such, they are atypical cases. A defence for their selection and the consequences it has will be given already in Section 2.4.1. *Chapter 7* will recapitulate the main findings and provide some conclusions with respect to the research question; the usefulness of the theoretical framework as such will be discussed; and lastly, some thoughts will be offered on how and in what direction research could fruitfully proceed from the work that has been undertaken in this thesis.

Chapter 2. Theory and Method

In this chapter, a framework for examining merger case outcomes will be developed. As suggested in the Introduction, competition policy is largely undertheorised from the point of view of political science in general¹ and international political economy in particular. Under such circumstances, a crucial part of the job becomes to create the framework as such, including developing valid categories and operationalisations. Thus, theory and method become closely interwoven and must be considered jointly. In the following, the central variables will be examined separately before they will be linked to provide possible explanations for merger case outcomes. Finally, some more specific methodological considerations will be made.

2.1 *The Elements of an Explanation: Dependent and Independent Variables*

2.1.1 The Dependent Variable

The general concern of this thesis is with why the outcomes of merger decisions differ between jurisdictions when the same cases are reviewed and the markets affected are identical. As such, it is not whether a merger is approved or not that is of interest, but rather the fact that outcomes diverge. As a matter of practical inquiry, however, the task must be one of analysing each outcome individually, after which a comparison can be made. Thus, the unit of analysis is merger case review in one jurisdiction and the dependent variable is *merger case outcome*. The variable can take one of three values: approval, conditional approval, or prohibition. While the former and latter are self-explanatory, the second needs further clarification: Conditional approval is the outcome in a case that would have been prohibited as it stands, but which is approved due to structural or behavioural undertakings agreed to by the merging parties.

The outcome of merger cases can, theoretically, be seen as a direct function of the assessment of the facts of a case. In a given market, three factors are typically

¹ Although empirically rich, organization theory contributions generally offer limited theoretical insights.

considered: the harm that a merger may cause; the entry conditions for the relevant market; and possible efficiency gains. To put it in the form of a general equation²:

$$\text{Outcome} = f(\text{harm, entry conditions, efficiency gains}) \quad (1)$$

Thinking in simplistic and stylised terms, one may then expect that when two agents assess the same merger, they should reach the exact same conclusion. In the cases that are of concern here, they do not. Taking the right-hand side of the equation as the point of departure, two explanations can be offered for this apparent paradox: Two reasonable minds may interpret facts differently, even if applying the same standards; alternatively, they may apply different standards when assessing the evidence. The first possibility can never be ruled out as long as merger reviews involve some discretion. From a policy-point of view, however, the difference is more fundamental if it is due to different standards. Then, one may expect more frequent clashes with the economic and political consequences that may have.

Five factors can be identified whose interpretation may have a significant impact, alone or together, on what outcome is reached. The first three are directly related to the factors identified in equation (1); the last two concern the approach taken to merger review more generally. Firstly, most mergers affect several (groups of) actors, and often in different ways. Thus, to evaluate whether a merger causes harm or not, one must first answer the question of *what and whose interests shall be protected or promoted*. In particular, one can distinguish between assessing the effects on consumers and on producers, or on any subgroup or combination of the two. Secondly, before one can evaluate the entry conditions of an industry, one must define *what is meant by barriers to entry* in the first place. While some consider hardly anything to constitute a barrier, others include almost any large expenditure to start up a business. Thirdly, it is not given *how efficiency gains should be assessed*; they may be considered both as a defence for and as an offence to a deal. The fourth factor concerns *what time perspective is taken when considering the effects of a merger*. In some cases, the short and longer term effects (with respect to harm, entry conditions, and/or efficiency gains) may be opposite, making the outcome dependent on the focus

² This is not to say that outcomes are a straight-forward mathematical function of the evidence, although economic textbooks sometimes portray it that way. Rather, the equation is used to illustrate what factors are “baked into” an outcome, which will prove to be essential to explain divergence.

of the decision-maker. Lastly, there are cases in which it is ambiguous, at the time a decision must be made, whether potential negative effects of a merger will ever materialise. The two main options facing a decision-maker is thus to block it *ex ante*, or approve it and rather deal with any problem that may arise *ex post*. Each of these factors will be discussed in detail below, both with respect to their precise meaning and with regards to whether the interpretation of one factor may be linked to the interpretation of another and even reflect an underlying dimension. In summary, equation (1) from above could now be extended to

Outcome = f (harm_{ij}, entry conditions_{ij}, efficiency gains_{ij}, time perspective_{ij}, ex ante/post_{ij}) (2),
where i and j symbolise different interpretations of each factor.

Different outcomes may be the result not only of different opinions of how facts relate to a standard or of different interpretations of the standards, however: A merger may be evaluated according to a different logic and thus, a whole different set of factors. What that logic and those factors may be will be discussed extensively below. Generally put then, a third equation may look like this:

Outcome = f (other factors) (3)

There is a bias, however, in the “legitimacy” of different factors. The ones identified in equations (1) and (2) are generally seen as the appropriate ones for assessing a merger and reaching an outcome; thus, “other factors” are likely not to be explicitly and officially included in a decision, even if they actually dictate the outcome. As such, not only the official decision but the circumstances surrounding it must be examined. A proposal for a systematic way to do this will be put forward in section 2.2.6.

In sum, it seems fair to say that an outcome is a function of how a merger “scores” on certain factors, where the choice or interpretation of factors may differ between jurisdictions. Thus, before one can explain why decision-makers reach a particular conclusion, one must discuss the outcome as such. For this reason, a substantial part of the case studies will be devoted to assessing what the value of the dependent variable is, going beyond the categories “approval”, “conditional approval”, or “prohibition”. Only on that basis can one move on to the next step: To explain why particular outcomes are reached and, subsequently, why they differ between jurisdictions.

2.1.2 The Independent Variables

Two independent variables will be brought into play for this task. The first, and most fundamental, concerns the *degree of competition policy autonomy*. Autonomy is most frequently discussed as a matter of independence from politically motivated interference by elected politicians or other government agencies (Majone 1996); here, societal actors will be included as well. The variable can be seen as continuous with the extreme values being complete autonomy and no autonomy. It can, moreover, be examined on three levels: as a principle (Section 2.2.1); as formally put down in laws and regulations and expressed in the degree of structural independence of competition agencies (Chapter 3); and as *de facto* freedom for the authorities to decide on the outcome of a merger case based on certain standards (below and Chapters 5 and 6).

The second explanatory variable, which intervenes between the degree of autonomy and the dependent variable, is concerned with *which group(s) of actors that sets the premises for the outcome of a merger case*. If there is complete autonomy, technocrats in competition agencies assume the centre stage. The discussion can then move straight on to what ideas or interests motivate their decisions. If there are limits to autonomy, on the other hand, it becomes important to identify which actors may have an interest in a merger case, what these interests are, and which actors and interests can be realistically expected to be in a position to set premises for outcomes.

2.2 Creating a Framework for Explanation: Linking the Variables

Having identified and discussed the dependent and independent variables on a stand-alone basis, the task of this section is to suggest possible ways in which they may be linked, and through that, an account for why a particular outcome is reached in a merger case. Two strands of explanations – which can be seen as falling within two different approaches to social inquiry – can be offered: one is idea-based; the other is interest-based³. While the former focuses on how autonomous technocrats make decisions informed by the ideas present in the competition agency, the latter sees outcomes as the results of battles between societal interest groups. What the ideas are,

³ The difference between an idea-based and an interest-based approach is often framed as a difference between social constructivism and rational choice. This study, while finding the distinction between ideas and interests to constitute a useful framework, will not engage in the ontological and epistemological debates often associated with the other set of concepts.

in the first case, and who the relevant groups and what their interests are in the second, will be discussed below. The two approaches part on the issue of competition policy autonomy; hence, this is the logical place to start the discussion.

2.2.1 Point of Departure: Competition Policy Autonomy

As this thesis is not just, and not even primarily, a theoretical discussion of competition policy, it is important to have an understanding of the politico-economic environment in which it operates. As discussed in the Introduction, liberalism is currently enjoying an almost hegemonic position in the (Western) world. This is at least true in principle; it is not difficult, however, to find examples of policy areas which deviate from the rule formally as well as in practice. The latter two levels will be examined later in the thesis; here, autonomy will be discussed on an abstract level by asking two questions: Normatively, *should* competition policy be autonomous? And if it should, can one, descriptively, *expect* it to be autonomous? As will be shown below, there is an asymmetry between the answers.

The first question concerns why some policy issues are granted autonomy in the first place. In the majoritarian model of democracy, public policy is only legitimate to the extent that it is subject to control by persons directly accountable to the electorate; delegation of power to independent agencies would seem to violate this principle. A justification is often given in terms of the properties of the issue (Majone 1996). A widely used typology distinguishes between four kinds of policies: redistributive, distributive, regulatory, and constituent (Lowi 1972). The point of autonomy is best illustrated by comparing the first and the third: Redistributive issues, like tax policy, have the effect of improving the conditions of one group in society by transferring resources from another; thus, the argument goes, it must remain under the direct control of democratically elected politicians. Regulatory issues, on the other hand, are typically concerned with circumstances where the unregulated market produces sub-optimal outcomes for the society as a whole. In such instances, liberalism prescribes that actions should be undertaken to increase overall welfare, which translates into finding technical solutions to the problems at hand. Experts, or technocrats, are best qualified to do that job, independent of external agents who represent special interests.

When framed this way, the greatest threat to legitimacy is no longer autonomy, but rather politically motivated interference⁴. This is not to say that regulatory issues do not have redistributive consequences: Market failures typically enrich the few at the cost of the many; correcting them would turn the tables.

Tranøy (1998) has offered a systematic way to examine the second question of how easily disconnected (or autonomous) a policy issue can be expected to be from identifiable and organised societal and political groups of actors. Although a more thorough discussion of which actors are involved and what their interests are must wait until Section 2.2.3, a rough answer can be offered already at this point, focusing on the difference between producers (firms) and ultimate consumers.

The first aspect to consider concerns how dispersed the costs and benefits of a policy are. If spread out thinly, they will give rise to non-intense preferences, and *vice versa* (Wilson 1973). While competition policy interventions generally affect firms – the merging parties, their competitors and sometimes also suppliers and buyers – in a direct and forceful way, the consequences for each ultimate consumer are typically much smaller. The second aspect is about whether the benefits from achieving a particular outcome, if they are at all tangible, would be non-dividable and excludable (Taylor 1976). For firms, the answer would be ‘yes’: A merger would typically increase the profits of the involved parties at the cost of their competitors. Consumers, on the other hand, would in a large majority of cases, be uniformly affected: If one group gets a better price, others would too. Related to this point, a third aspect concerns whether people are organised in a way that is relevant to the effects of a policy action. While that is by definition the case for firms affected by a merger, it is less common that consumers are organised as buyers of, e.g., airplane tickets, hair-cuts, or orange juice. The last aspect relates to how easy it is to decide what the effects of a particular policy intervention actually is. While it is generally clear to producers, the single consumer will normally have a hard time establishing what the consequences of a merger will be, as it is a complex, technical, and highly

⁴ Majone has argued that to be perceived as legitimate, autonomous regulatory agencies must also be subject to procedural, indirect control mechanisms. These include that “the agencies are created by democratically enacted statutes which define the agencies’ legal authority and objectives; that the regulators are appointed by elected officials; that regulatory decision-making follows formal rules, which often require public participation; that agency decisions must be justified and are open to judicial review” (Majone 1996:291).

information-intensive matter. The effects are, moreover, frequently modified by other actors (intermediate purchasers) before they reach the ultimate consumer.

In sum, there is a good case for why competition policy, when seen from a liberal point of view, *should* be granted autonomy. At the same time, it is evident that firms, and, as will be discussed in Section 2.2.3, several other groups of actors, have a clear interest in undermining this autonomy if it means that the outcome would be more beneficial. Whether they succeed or not must be a matter for the case studies to decide.

2.2.2 Technocrats, Autonomy, and Ideas

Within the field of international political economy, and international relations more generally, there is a growing literature on the relationship between ideas and policy (see Goldstein and Keohane 1993; Risse-Kappen 1995; Checkel 1998, 1999; Ruggie 1998; Risse, Ropp and Sikkink 1999). It is not coherent, neither with respect to theory nor to methodology nor to what empirical issues are examined, but the contributors all share the contention that strategic calculations of material self-interests cannot (alone) explain outcomes; ideas, in some way or another, have significant influence on polity, policy and politics.

In a field like competition policy, where it is, in principle, left to autonomous technocrats to make decisions, it becomes important to examine what ideas or ideological positions are predominant and likely to inform actions. Below, it will be argued that the professional training and institutional affiliation of technocrats have significant impact on what is seen as appropriate behaviour. First, however, a very different and hard-wearing position should be briefly discussed: the one that perceives bureaucrats as maximisers of narrow, material self-interests, such as salaries, career prospects, and prestige. The best means to achieve such ends, the argument goes, is to oversupply their services to get larger budgets (Buchanan and Tullock 1962; Niskanen 1971, 1991). A similar “cynical” view can be found in the literature on professions: Professionals opportunistically seek exclusivity for their group primarily to enjoy the benefits that come with monopoly (Friedman 1962). Such accounts have been heavily criticised both on theoretical and empirical grounds (see Egeberg 1995).

The alternative to the cynical position is sometimes portrayed as “naïve”: Professionalism is seen as the functional expression of intellectual progress, and professionals are perceived as altruistically working for the benefit of all. As Tranøy (1998:14) has pointed out, this opposition may be misplaced and it may be more fruitful to see “professional training as instilling an overarching sense of purpose and a method for achieving these standards in the members of a profession”. Another factor that may have a profound impact not only on norms and procedures, but also on the very identity of technocrats, is the institution of which they are members. Within an institutional framework, the choice between different actions is seen as based on what is defined to be appropriate rather than on the “logic of consequences” that underlies models of rational action (March and Olsen 1989). For the idea-based approaches, socialisation and learning become key concepts to explain why actors comply with ideas, norms and rules (Checkel 1999). To the extent that the professional and institutional standards are perceived as compatible, they may not only live well together, but also reinforce each other. When they differ, however, it may be sensed as more than a conflict between different choices; March and Olsen (1996:252) see it as a clash “among alternative concepts of self”.

In the case of competition policy, two different professions occupy the agencies: economists and lawyers. This could, *a priori*, be seen as providing for constant disputes within the institution. The premises that form the basis for decisions have indeed been shown to differ somewhat between the two groups: While the former is generally most concerned with efficiency issues, the latter pays more attention to the rule of law (Zuna 1999). However, to the extent that there is one idea or coherent set of ideas underlying competition policy, the number of cases in which the two groups disagree would be dramatically limited. The academically dominant version of industrial or antitrust economics is in accordance with, and indeed the operationalisation of, liberalism; the content of competition laws will be discussed in the next chapter. There may, furthermore, be institutional mechanisms in place designed to resolve conflicts, if they arise. Lastly, the competition agencies have to reach *one* outcome, thus facilitating discourse between the two professions. As this is

done routinely in several hundred cases each year, the exchange of ideas and opinions may itself become institutionalised.

Another, and potentially more serious, challenge to the uniformity of norms and procedures arises from the fact that ideas on what is appropriate behaviour change over time. It is not the commission here to discuss how and why ideas (and policy) change as such; it is worth noting, however, that once a set of beliefs has become institutionalised, it can prove to be hardwearing and have influence long after new ideas have been introduced (March and Olsen 1989; Goldstein and Keohane 1993).

Despite the difference displayed between cynical views on bureaucrats and the more “favourable” approach discussed above, doing a good job and pursuing narrow self-interests may well amount to the same. In a merit-based system, promotions are rewards for good performance, and have a disciplining impact (Egeberg 1995). To the extent that values and goals of the organisation are internalised, external control mechanisms of course become more or less redundant (Egeberg 1999:458).

Overall, a reasonable case can be made for perceiving technocrats as something more than selfish, narrow-sighted maximisers of salaries and prestige; they may have a strong and genuine interest in doing what is “right” or “appropriate”. Under the current politico-economic regime, such standards are informed by liberal ideas – of some sort. Thus far, these ideas have been presented as homogeneous and clear-cut. For the purposes of discussing autonomy and the basis for technocratic actions this has sufficed; in the upcoming examination of the US and EU competition authorities (Chapter 3) and the case studies (Chapters 5 and 6), however, there is need for a finer-grained understanding of liberalism. There are potentially many different versions that could have made for interesting analyses. Here, two, which can also be seen as theories of political economy, are singled out: neo-liberalism and Ordo-liberalism. Below, each will be discussed in turn by defining its main goals and the means to achieve them as well as the preferred institutional build-up of competition agencies. As antitrust economics today is most often associated with neo-liberalism, central logics and concepts that will be applied in the subsequent case studies will be explained and discussed under that heading. Which, if any, version of liberalism has

influence on technocrats, and subsequently on outcomes, will be a matter for the empirical investigations in Chapter 3 and Chapters 5 and 6.

Neo-liberalism

The goal of neo-liberalism is to maximise (global) welfare, and little or no attention is paid to policy areas such as security and defence. The term ‘welfare’ is used narrowly and is equivalent to ‘economic efficiency’, which is reached when all resources in society are assigned to their best uses. This has two facets: Allocative efficiency refers to the placement of resources in the economy as a whole; productive efficiency concerns the internal use of resources within a firm (Bork 1978:91-101). Efficiency in this sense can only be obtained through competition in free markets. Hence, to neo-liberals, *competition is the means to achieve efficiency, not a goal in itself*.

As a starting point for the following discussion, consider the assumptions of a perfectly competitive market: all agents are price takers; production functions are constant, i.e., there is no room for scale, scope and learning curve economies or technological change; firms can enter and exit markets without costs; products are homogenous; both consumers and producers have perfect information; and there are no externalities (Pindyck and Rubinfeld 1998:694; Viscusi et al. 2000:76). None of these assumptions hold perfectly in real life, and although neo-liberals have great faith in the self-regulatory capacity of the market, there are cases where government intervention is necessary to restore competition⁵.

The rationale for competition policy arises from the fact that not all agents are price takers. Rather, some firms have (some degree of) market power, i.e., the ability to raise price above marginal cost. At the same time, they will reduce output. This will result when there is not enough competition in a market, either because of the market structure or the conduct of firms. The central question then becomes how market power affects the goal of maximising welfare. The concept of *total (or economic) surplus* has proven useful when trying to provide an answer. It is the sum of *consumer*

⁵ A branch of neo-liberalism often associated with some members of the Chicago School like Milton Friedman and George Stigler would argue that there are hardly any instances in which government interference will improve the outcome of free competition, even in the case of market failure. The reason is the limited understanding governments have of how markets work and how their actions affect not only the market in question but also spill over to others related to it, directly or indirectly. Such “regulatory failure” is considered more likely and damaging than market failure. Here, a more “moderate” version of neo-liberalism is discussed.

surplus, i.e., the difference between the price consumers are willing to pay for a good and what they actually pay, and *producer surplus*, i.e., the sum over all units of production of the difference between the market price of a good and the marginal cost of production (or put simpler, the profit of the firms in an industry). When a firm gains market power (e.g., as the result of a merger) and reduces its output, the effect will be a loss in consumer surplus. Some of it will be extracted by producers as extra profit and not affect total surplus; some of it, however, will be lost altogether as the new output is smaller than what is socially desirable, decreasing the total welfare in society (known as a deadweight loss)⁶. The effects will be the greatest in a pure monopoly, although similar results will prevail also where firms hold *some* market power (Viscusi et al 2000:ch. 5).

Two important reasons for why some markets are more concentrated than others arise when one relaxes two more assumptions of perfect competition, namely that economies of scale, scope, and learning curves do not exist and that there are no barriers to entry. A firm gains economies of scale if its average cost of production falls when it increases its scale of operations⁷. One reason is the potential for specialising capital, labour and services; another is that fixed costs decrease as they are spread across more units. Economies of scope exist where it is less expensive to produce two products together than it would be to produce each one separately, e.g., because two products require similar machinery or labour skills or use the same distribution channels. Moreover, there may be economies of both scale and scope from coordinating research and development, managerial expertise and advertising. A firm's production costs may also fall over time as managers and workers become more experienced and more effective at using available technology and equipment; this is known as learning curve economies. The effects of economies on competition will be discussed in greater detail in Section 2.2.5.

⁶ There are two additional kinds of losses arising from monopoly power. The first results from X-inefficiencies, which arise because the lack of competitive pressure may result in motivation problems and divergent goals of managers, owners and employees (Leibenstein 1966). The other loss arises from competition among agents to become a monopolist, and include the use of resources for lobbying and lawyers (Viscusi et al. 2000:85). For the purposes of this thesis, only deadweight loss will be considered, both because it makes the largest contribution to inefficiency, and because this is what the competition authorities look at when considering the effects from anticompetitive practices.

⁷ A *natural* monopoly arises when there are so large economies of scale that it is cheaper for one firm to produce all of the industry output rather than many firms producing small portions of that output. In this case, the issue for government becomes one of reducing prices below what the monopolist would charge while still allow it a "fair income".

If there are high costs to entry, there will tend to be fewer firms in a market than if the costs are relatively low. More important in the context of antitrust economics is the question of how entry conditions determine the degree of *potential* competition. It is generally believed that a credible threat of entry will induce firms to compete vigorously and keep prices close to costs. If they do not, new firms will enter the market, undercut prices and take over market shares (von Weizsäcker 1980)⁸. The question of exactly what barriers to entry are is, however, a controversial issue among economists. At one extreme, there are those who argue that the only real barriers are government restrictions like patents or tariffs; at the other, some consider almost any large expenditure necessary to enter an industry a barrier, including high capital requirements, existing firms' cost advantages like learning curve economies or superior technology, costs of marketing a new product, and the aforementioned scale and scope economies⁹. Moreover, these entry barriers have very different welfare implications. A tariff is welfare reducing; superior efficiency from learning curves is a "good" barrier. Hence, removing a barrier to entry does not necessarily increase welfare. Viscusi et al. (2000:160) conclude their discussion in this way:

"The concept of barriers to entry lacks clarity, and one is never sure what to do with it. (...) The best advice we can offer is to perform a two-stage inquiry. In the first stage, carefully examine the assumptions underlying the particular argument that something is a barrier. Determine whether it is indeed true that existing firms can maintain price above cost while deterring entry. In the second stage, consider whether there is a policy that could 'remove' that barrier and improve social welfare."

This section has shown that the presence of market power distorts the neo-liberal goal of economic efficiency. How mergers can affect both market power and efficiency, and the resulting prescriptions for competition policy, will be discussed in detail in Section 2.2.5. Moreover, central concepts that have been discussed abstractly above (like economic surplus; scale, scope, and learning curve economies; and entry barriers) will be applied more actively. In the sub-section below, the neo-liberal recommendations for how to design a competition agency will be explored.

⁸ The theory of contestable markets claims that the threat of potential entry may be enough to keep the industry operating at or close to the competitive price and output even if there is only *one* firm in the market (Baumol et al. 1982). This theory is, however, quite controversial.

⁹ The former position is often advocated by Chicago School economists like George Stigler (1968) while the latter is associated with Joe S. Bain (1968).

Neo-liberal Prescriptions for Competition Policy Institutions

The simple statement that the single goal of neo-liberalism is the maximisation of economic efficiency has two powerful implications for the design of the institutions that shall enforce competition policy: Firstly, the institutions must be independent from societal interests who may promote different goals; secondly, in order to decide whether to intervene in the market or not in a specific case, economic experts must analyse its effect on total surplus.

The institutional solution is the establishment of a single-purpose agency “operating outside the line of hierarchical control or oversight by the central administration” (Majone 1996:47-8). It shall enact a concise law which lays down basic principles and procedures that reflect the economic theory outlined above. It is impossible, however, to design a law that prescribes actions for all eventualities without jeopardising the economic soundness of a decision. Hence, the law must necessarily leave room for some discretion. That makes it all the more important that the agency is staffed with highly skilled economists with some legal knowledge who can use their professional judgement to decide on the effects of a merger. Taken together, the structural independence, the clarity of the law, and the professionalism of the staff should produce an agency capable of making transparent and predictable decisions and withstand pressure from societal interests.

Even these measures cannot guarantee, however, that the agency makes decisions based solely on a concern for efficiency. This has led some to argue in favour of judicial review by the courts or even of the separation of investigatory, prosecutorial, and decision-making functions (Posner 1992:ch.22; Laudati 1996).

Ordo-liberalism

Having discussed neo-liberalism in some detail, the focus will now shift to Ordo-liberalism. It can be ascribed quite firmly to specific authors and particular historical circumstances: It originated in the 1930s under the lead of Walter Eucken and Franz Böhm at Freiburg University, Germany, and was strongly influenced and motivated by

the fall of the Weimar Republic and the rise of Nazism¹⁰. A second group of thinkers, including Alfred Müller-Armack, Alexander Rüstow, and Wilhelm Röpke were closely associated with the Freiburg School, and they were jointly referred to as the *Ordo-kreis*, named after their journal, *Ordo: Jahrbuch für die Ordnung von Wirtschaft und Gesellschaft*. Ordo-liberalism was formulated as an abstract theory, however, which will be reflected in the following discussion.

There appears to be no single clear goal in Ordo-liberalism; there are variations both between scholars and over time¹¹. Three main classes of objectives may be identified, however. The first is concerned with the preservation of individual liberties, of the autonomy of the common man, and of human dignity. This is not only a matter of political rights; the individual should also have freedom in the economic and social realms. The second set of objectives is directed at economic development and growth and the efficient allocation of scarce resources in society. The last group of goals encompasses a limited conception of social equality. While Eucken considered social policy only as a subsidiary measure and believed that in the large majority of cases access to the competitive process would suffice, most Ordo-liberals want to go further and include a moderate redistribution of welfare (Eucken 1952/1990; Lenel 1989). Müller-Armack went the furthest and called for a ‘social market economy’ (*Soziale Marktwirtschaft*), which was intended to combine the free market with social adjustment (Müller-Armack 1956/1989)¹².

All of these goals are mainly considered to be compatible and even complementary, but there may be cases where they conflict. Economic efficiency, for example, may require a degree of market concentration that is incompatible with individual liberty. In such cases, Ordo-liberals would in general decide in favour of “freedom as the ultimate goal” (Eucken 1948/1989:34). The key to understanding how the objectives can be reached lies in the crucial role assigned to the economy.

¹⁰ For a discussion of the roots of Ordo-liberalism and the historical context in which it was founded, see e.g., Tribe (1995) and Gerber (1998).

¹¹ For a good illustration of the scope of goals, see the two volumes edited by Peacock and Willgemodt (1989a and b), which contain collections of articles published by the above-mentioned members of the *Ordo-kreis* and present-day scholars, respectively.

¹² Müller-Armack also brought this politically useful concept and its content with him into the Christian-Democratic Party (CDU). There he had a close ally in Ludwig Erhardt, who was appointed Minister of Economics in the first government of the Federal Republic of Germany in 1949, and Chancellor in 1963. Erhardt managed to implement several basic principles of Ordo-liberalism and the social market economy, although watered down by political trade-offs.

Explained Eucken (1948/1989:37): “The problem of freedom in the modern world is very closely connected with control of the economic process. It has to be established which system will guarantee freedom and at the same time prevent the misuse of the rights endowed by freedom”. The Ordo-liberal answer is free market competition combined with the control of private economic and state power.

Competition does not only produce an efficient allocation of resources along the lines discussed in the sections on neo-liberalism; it also ensures freedom and social justice. On a general basis, the free market gives people the liberty to pursue individual objectives and the chance to express their own choices. In the political realm, private decision-making restrains the power of the state, a notion adopted from classical liberalism. More specific to Ordo-liberalism is the view that not only the state but also private agents with economic power represent a threat to freedom. This concern was, *inter alia*, a reflection of how massive cartels had used their position to destroy political and social institutions in the Weimar Republic. Thus, competition is seen as safeguarding freedom as no private agents are allowed to become so powerful that they can gain political influence (Böhm 1928/1960; Eucken 1940/1992). Economic freedom from coercion by other firms and the right to compete is also protected as long as competitive market structures are maintained. Competition is, moreover, perceived as upholding social freedom, facilitating equality, and indeed integrating the society around humane and democratic principles. For this to happen, however, the competitive process must be perceived as fair and provide equal opportunities for participation to all (Gerber 1998:241): The efficient working of the economy produces the welfare that is necessary for creating a better society; social hierarchies are less stable when results of individuals’ initiatives and performance in the market rather than of, e.g., political or clerical rules; and the opportunity to develop one’s own capacities in a free market is an important aspect of human dignity (Röpke 1944). Hence, to Ordo-liberals, *maintaining competition becomes a goal per se*.

Before discussing the implications of these views for competition policy, it will be instructive to take a step back and consider more closely how one gets from policy goals to policy instruments. Eucken argued that the key to understanding the economic reality is to think in terms of economic orders or systems (*Ordnungen*) and, through

economic analyses, find their basic underlying principles and ordering patterns. He maintained that on an abstract level, two main orders existed: (1) the free exchange economy, where private agents undertake the basic actions driven by the incentives created through economic competition; and (2) a centrally administered economy, where the government directs the activity based on a politically chosen criterion external to the economic system (Eucken 1940/1992:58). The two orders were considered to be fundamentally incompatible and should, hence, not be combined into a “mixed economy”¹³. Which order is chosen, however, is a matter of political and ideological preferences.

It is important to note that Ordo-liberals do not believe that a workable economic system can emerge spontaneously: rather, it must be deliberately constructed (Lenel 1989). The different components of this system must, moreover, be compatible and mutually supportive and flow from the same basic principles. Furthermore, the economy must be embedded in and conform to the other elements of the society: the political, social, legal, and ethical systems¹⁴. These interrelationships are manifested in an “economic constitution”, a “decision as to the general ordering of the economic life in a community” (Eucken 1940/1992:83; see also Böhm 1966/1989).

As discussed above, Ordo-liberals clearly prefer a free exchange economy to a plan-based one. More specifically, it should be founded on “complete competition”. This concept strongly resembles the “perfect competition” ideal of neo-liberalism, but puts, as reflected in the above discussion, more emphasis on the absence of coercive power (see Möschel 1989). The economic constitution for an exchange economy order is defined by constitutive and regulatory principles. The constitutive ones consist of institutional (in the widest sense of the word) requirements which assure the constancy and predictability necessary in a system otherwise characterised by constant change and uncertainty: private property rights, monetary stability, “open” markets, contractual freedom, personal liability for action, and policy consistency (i.e., no frequent changes in economic policy). The regulatory principles, which are more

¹³ Eucken did indeed see the introduction of command elements into the German and other European economies after WWI as a main reason why the market economy system had been gradually destroyed (see Gerber 1998:244).

¹⁴ The idea of embeddedness is close to that of Karl Polanyi, who argued that the economy must be anchored in political and social institutions (Polanyi 1957).

specific, are designed to prevent the market system from developing in undesirable directions, and, in the worst case, destroying itself (Eucken 1952/1990:254-89). This would be the outcome, according to Ordo-liberals, of an undiluted *laissez-faire* policy. Their objections to such a system can be grouped into three basic arguments (Barry 1989), which each give rise to a regulatory principle: First, an unrestricted market and monetary system is often unstable; second, it may generate a distribution of income that is unacceptable on social grounds; and third, in the absence of some kind of regulation, damaging monopolies and cartels are frequently created. These concerns give rise to policies that advocate stabilisation (in particular emergency provisions to prevent massive inflation or deflation), social welfare, and competition, respectively.

Hence, while trust in the freedom of markets is important, it is not sufficient: It must be combined with a distrust of forces that may interfere with it. This is the justification for having a strong, but limited state. As mentioned above, private economic agents may have power not only to destroy competition as such, but may also transfer the power into the political or social realms. A weak state will allow this to happen; a strong, independent one can resist it to the benefit of the whole society. At the same time, the state as such can be a threat to the system, and its room for manoeuvring must thus be limited to undertaking actions that are in conformity with the market. In practice, this is done by translating the principles of the economic constitution into legal acts, and restricting the powers of the state to implementing those acts. Moreover, it shall do this without discretion or exceptions, thereby guaranteeing the neutrality and objectivity of the law. Ordo-liberalism is thus deeply rooted in the theory of the *Rechtsstaat* (Böhm 1966/1989).

Ordo-liberal Prescriptions for Competition Policy Institutions

Ordo-liberalism is very clear on what kind of institutional framework is needed to implement competition law: A strong and independent agency shall assure compliance with the law while the courts shall have the right to review the decisions of the agency (Eucken 1952/1990). Each aspect will be dealt with in turn.

To assure complete autonomy from political interference, the competition agency shall have a quasi-judicial status and be placed outside of the executive branch.

Moreover, it shall be staffed by career bureaucrats with a high level of proficiency in economics and law. The agency shall have the sole responsibility to investigate possible violations of the competition law and have the authority to undertake the enforcement actions necessary to restore competition. This shall be done by applying judicial methods to clear statutes, with no room for discretion. Herein is a problem with the Ordo-liberal approach to competition policy as it evolved around the mid-1900s: Translating the economic principles of complete competition into a legal text that could again be directly applied to determine whether a case is in accordance with the law was seen as a straightforward exercise. This may be true for many issue areas, but does not, as discussed in this chapter, describe the reality for competition policy very well. Hence, some discretion must be allowed for.

The role of the courts shall, according to Ordo-liberals, be to ensure that the competition agency applies the laws correctly and let no other concerns influence its decision. Again, this was seen as a straightforward matter, as the acts shall prescribe exactly what actions the competition officials shall undertake. As this is not the case, however, one should expect judicial review to become all the more important in order to assure that the law has been interpreted correctly.

On the whole, the two versions of liberalism prescribe roughly the same institutional build-up of competition agencies; differences arise with respect to what policy the agencies shall pursue and for what reasons. This was discussed on a general basis above and will be explored further in Section 2.2.5.

2.2.3 Societal Interests and (Non-) Autonomy

The idea-based approach to social inquiry is challenged by those who see policy and politics as results of the actions of rational agents pursuing their (exogenously given) interests based on calculations of cost and benefits of different and fully understood alternatives¹⁵. There are different opinions on who the relevant actors are, and thus, what policy results. Pluralists, following the tradition of Robert Dahl (1961), see politics (in democracies) as a market place where different societal interest groups

¹⁵ Looking at how this debate has played out in academia, the statement should be reversed: the interest-based approach has been challenged by those who ascribe explanatory power to ideas.

compete to obtain their preferred outcome. Resources, and hence power, are seen as widely but unequally distributed among individuals and groups. In this view, government agencies are just one, and often diverse, set of actors among many others.

Regulatory policy in general and competition policy in particular are no exceptions. Thus, no matter how much autonomy is granted, *de facto*, policy outcomes will result from the battle between different groups. The winner will be the one that can mobilise the most resources behind its preferences. If the assertion is correct that not only competition authorities but potentially many other actors set the premises on which merger cases are decided, it becomes important to discuss who these actors may be and what their interests are. Below, selection is based on who could be reasonably expected to be affected by a merger and thus have an interest in its outcome.

Beginning with the competition authorities a distinction between lower-level and higher-level officials may be warranted. When the role and interests of technocrats were discussed above, it was with the former group in mind. As shown, it is not unreasonable to assume that in any other understanding than the cynical, which may border on “paranoid” (Tranøy 1998:15), they will see it as in their interest to perform well according to their (arguably liberal) standards. Their sources of power include their structural position as well as “moral superiority” arising from popular sentiment in favour of liberal ideas under the current politico-economic paradigm. Moreover, as Majone (1996:273) has argued,

“a regulatory agency which sees itself as part of a transnational network of institutions pursuing similar objectives and facing analogous problems (...) is more motivated to resist political pressure. This is because the regulators have an incentive to maintain their reputation in the eyes of fellow regulators in other countries; a politically motivated decision would compromise their credibility and render co-operation more difficult to achieve in the future.”

Moving on to higher-level bureaucrats, in a comparison of various models of civil service careers, Peters (1995:102) has pointed out how top officials in the US move “between the public and private sectors, with most people staying in government only a few years (...). The majority of these ‘in and outers’ would be in the political appointments made by the President and his cabinet.” Hill (1997:84) has shown that this is also not uncommon in Europe. It may thus be a reasonable assumption that high-level officials may have preferences that go beyond performing according to their job descriptions, e.g., in favour of the firm or industry for which they used to work.

They may also be more inclined to take into account the preferences of those who have appointed them. As they sit at the centre of the decision-making table, their chances of being heard are significant.

The next group of actors to be identified are those most directly affected by a merger: the parties to the transaction, their competitors, and frequently their suppliers and customers. Their preferences are given by how a deal will affect their businesses; their influence may be based on their ability to sway decision-makers directly through lobbying, on the one hand, and, on the other, to articulate their wants in broader terms, like their importance for regional development or employment. Concern for the latter may of course also be advocated by labour itself, typically organised through unions.

Although affected more indirectly, elected politicians, up to the level of prime minister or president, may also have clear interests in the outcome of a merger review. These may include egoistic short-term concerns for re-election, which may make them particularly sensitive to consequences for, e.g., employment in their constituency, and genuine worries for the well-being of their voters. Politicians may, due to the weight of their opinions as representatives for a large number of people, set important premises for outcomes. A head of government would of course have a particularly wide range of tools to influence a decision.

Government departments and agencies other than the competition agency may also have an interest in mergers. Both sector-specific units like those responsible for defence, transportation or fisheries, and general-purpose ones, like departments of trade, industry, or research, may have preferences for the outcome of a case, based on the objectives that they are set to obtain. As they are strategically placed within the government and may be central in providing information and analyses to the competition authorities, their potential for delivering premises on which decisions are based, should be large.

An important dynamic arises from the fact that the interests of different (groups of) actors may overlap, at least in the sense that they prefer the same outcome, if not for the same reasons. In some cases, such actors will fight side-by-side; in others, one group may pick up the concerns of another (perhaps less organised or influential) group. Securing jobs, for example, is in the direct interest of labour unions; it may be

used by the top management of firms to win popular support for a deal; while elected politicians may flag the issue, if nothing else to be re-elected. Going further than the occasional overlap in preferences, a cluster of concepts/models/theories has suggested that there may also be a “variety of separate linking systems between interests within government and those outside” (Hill 1997:71)¹⁶. The notion of “regulatory capture” has been used to describe the situation in which a government agency represents special interests, in particular those of an industry, rather than the broader public good (Stigler 1971). A more balanced relationship between state and industry, in which the parties depend on each other, is caught in the expression “iron triangle”, the most famous of which is the “military-industrial complex” (Mills 1956¹⁷). A third concept, (societal) corporatism, emphasises the representation by a number of well organised interest groups which are recognised by the state and have privileged or even monopolistic access to it (Schmitter 1974).

To work effectively, the interaction between state and interest groups should be stable and frequent. This is best achieved in dealings with single-industry government agencies or parliamentary committees. Competition agencies, and in particular lower-level case handlers, are less likely to take part in any such arrangement¹⁸. Moreover, in merger cases, two firms which are members of the same industry group may, depending on whether each is a party to the transaction or a competitor, disagree on whether a merger should be approved or not, reducing the impact of the original linkages.

More generally, which (groups of) actors are activated and to what degree their interests are coherent will vary between different mergers, depending, *inter alia*, on the characteristics of the companies, the structure and relative importance of the industry in which they take place, and the surrounding environment. One could assume that, *ceteris paribus*, lower-level competition officials would be more likely to win through in cases that create little noise and which do not mobilise “heavy” interests. The merging firms will be present in all cases as will their competitors; thus, the

¹⁶ In discussing such links, one is moving away from pluralism to a theory of “the power elite” (Mills 1956).

¹⁷ The term was popularised through President Dwight Eisenhower’s farewell address to the nation in January 1961.

¹⁸ For a good discussion of regulatory capture in the context of (EU) competition policy, see Neven et al. 1993.

activation of politicians and state agents will probably make more of a difference when it comes to influencing the outcome of a case.

The focus in this thesis on mergers that affect multiple jurisdictions adds an international perspective to the discussion. This has several important consequences. Firstly, an additional group of actors must be included: governments as such. This is not to say they are unitary or “black boxes”, although there may be cases where the interests of a country are relatively uniform. Alternatively, the country’s position on the international arena may be shaped and limited by what is considered acceptable by the domestic constituency (Putnam 1988). Yet another possibility is that the arguments merely reflect the preferences of the state leadership. This implies, secondly, that there may be such a thing as a “national interest” (the content of which will be defined below). Such interests will typically be most forcefully and directly advocated by politicians and state agents; thus, these actors are likely to take the front stage in cases that involve several jurisdictions. Firms may also frame their preferences in such terms, however, to put weight behind their arguments and to get the attention and protection of the government. Thirdly, the internationalisation of the issue and “nationalisation” of the interests may illuminate the redistributive effects of competition policy. This may make politicians more inclined to intervene and put their resources behind a particular outcome, at the same time as it unifies the domestic pressure groups. Fourthly, the groups will have to defend and promote their interests not only on one, but on two arenas. Some of them, including sub-governmental units, may find that their preferences differ from what is perceived as the national stand, and may find it easier to gain support for their position in the foreign rather than their home jurisdiction.

After this broad discussion of groups and interests, there is a need to narrow it down to those which will be perceived to be the most important premise-setting actors, which will carry into the subsequent analysis. The competition authorities, both the lower-level and top officials, are at the structural centre of any decision and will as that be included. The international scope of the empirical material and the following weight on national interests indicate that elected politicians and state departments and agencies may be central in setting standards for the outcomes. They may also be

sympathetic to, and pick up on, the interests of national firms and labour. For this reason, the latter groups will only be assigned minor roles in the analysis. This is not to say that they will be ignored; their role in mobilising their government as well as their formal role in merger investigations will be discussed in the case studies.

One theory of political economy that centres on the relative strength of states in the political and economic realms is neo-mercantilism, and this will be taken as expressing the main concerns raised by agents other than lower-level competition officials in multi-jurisdictional mergers¹⁹. It will be discussed along the same lines as the two liberal political economy theories: main goals and the means to achieve them will be identified and the preferred institutional build-up of competition agencies will be examined.

Neo-mercantilism

Mercantilism has its roots in 16th century Western Europe and was based on the premise that national wealth and power were best served by increasing exports and collecting precious metals in return. It got a somewhat firmer theoretical base with the writings of Alexander Hamilton (1791) and Friedrich List²⁰ (1841). Both argued in favour of the supremacy of industry and manufacturing over agriculture, and advised governments to take necessary actions to ensure industrialisation by protecting infant industries. This would, they asserted, provide the basis for economic self-sufficiency, military power, and political autonomy, and have important spillover effects onto other parts of the economy. Since then, many different variations of this group of more or less comprehensive theories have been presented. Here, the starting point will be Robert Gilpin's classic book *US Power and the Multinational Corporation* (Gilpin 1975a), which will be extended with his subsequent writings as well as contributions from other scholars.

¹⁹ It has been suggested that neo-mercantilism, as a defence of *national* welfare, should be distinguished from protectionism, as an expression of *private* interests (Hveem 1996). This was discussed above in terms of whether actions originate within the government itself or as a result of firm pressure. Although analytically helpful, the distinction will only be carried implicitly out in the case studies in examinations of whether a particular merger is a good candidate for (narrowly understood) neo-mercantilism. In the broader discussions, firm-initiated actions will, once picked up by government actors, be included as part of the national interest.

²⁰ It should be noted that List only argued in favour of infant industry protection for a limited period of time. Once a country had reached a certain level of industrial development, it should engage in free trade with countries at a similar level. For an interesting discussion of how List's ideas have been central in the economic development of today's rich countries and how developing countries are denied the right to apply the same strategies, see Chang (2002).

Neo-mercantilism borrows the important premise from (neo-)realism that the world is anarchic and that conflict prevails over harmony. Hence, the most important task for a government is to ensure the survival of the state and its citizens²¹ (Hobbes 1651/1998; Waltz 1979). In other words, neo-mercantilism maintains the concerns of classical mercantilism with state building, national security, and international influence. From these general goals, two versions of the theory have been developed, namely the “benign” and the “malevolent” (Gilpin 1975b). Adherents of the first category are defensive positionalists without ambitions beyond ensuring national and international security for their country, while the latter group rather regards the international economy as an arena for aggressive expansionism.

In general, neo-mercantilism takes a negative view on the chances for international cooperation. The reason is the weight put on relative gains²²:

”The essential fact of politics is that power is always relative; one state’s gain in power is by necessity another’s loss. Thus, even though two states may be gaining absolutely in wealth, in political terms it is the effect of these gains on relative power positions which is of primary importance. From this *political* perspective, therefore, the mercantilists are correct in emphasizing that in power terms, international relations is a zero-sum game.” (Gilpin 1975a:34)

For cooperation to take place then, it must produce balanced and equitable gains, i.e., a distribution of gains that does not change the pre-cooperative balance of capabilities between the parties.

Despite the centrality of power, neo-mercantilism departs from realism with regard to the latter’s view that *only* power matters for a country’s position. Since World War II, neo-mercantilism has gone beyond the traditional goals and been strongly committed to promoting domestic welfare and stability (Hager 1986; Jones 1986; Gilpin 1987). And although politics and security are given priority over economic activities, the pursuit of power and wealth are seen as largely complementary: Economic factors play a central role in international relations and

²¹ The EU is, of course, not a nation state, despite the fact that its powers have increased significantly both in depth and scope since it was established almost 50 years ago. This does not, however, render neo-mercantilism irrelevant when discussing the EU. In particular, when pitted against external powers, it is not unreasonable to assume that European politicians and state agents may think in terms of how actions affect not only the countries that they are from, but also the Union. This should be especially true for members of the European Commission, as they are assigned the role of representing the EU as a whole (see footnote 57). When, in the following discussion, ‘country’ is used, it should thus also be taken to encompass the EU.

²² It seems to be a favourite exercise for scholars of neo-realism and neo-mercantilism to illustrate this point by the game theoretical model of the “Prisoner’s Dilemma”.

power does to a large degree *rest* on economic and industrial capabilities. Explains Jacob Viner (quoted in Gilpin 1987:32):

”(1) [W]ealth is an absolutely essential means to power, whether for security or aggression; (2) power is essential or valuable as a means to the acquisition or retention of wealth; (3) wealth and power are each proper ultimate ends of national policy; (4) there is long-run harmony between these ends, although in particular circumstances it may be necessary for a time to make economic sacrifices in the interest of military security and therefore also long-run prosperity.”

Achieving these goals requires an active government that is heavily involved in the economy. Gilpin (1987:212-3) separates between three kinds of economic strategies that states can use:

- (1) macro policies, i.e., efforts of state on aggregate level to facilitate smooth operation of markets and accumulation of basic factors of production (monetary and fiscal policy, education, encourage a high rate of savings, etc.);
- (2) compensatory policies, which shall compensate losers in times of rapid changes (traditional welfare state programs such as unemployment insurance); and
- (3) structural adjustment/industrial policy, which is meant to affect the ways in which the economic structure reacts to outside forces or tries to assume international leadership in an industry.

Macro and compensatory policies are used by all countries and are in most cases not controversial. They are applied broadly to the whole society and do not target any specific sector. Hence, they do not account for a crucial difference from liberal views and will thus not be discussed further here. Policies that fall within the third category, on the other hand, are highly contentious and subject to frequent criticism in today's international politico-economic regime.

While liberalism maintains that every country has a comparative advantage in one industry or another, which is static and determined by its natural endowments, neo-mercantilists claim that comparative advantages are dynamic. Consequently, governments can *create* an advantage by supporting a certain sector and hence influence who produces what. This is significant because some industries are assumed to be more important for a country's wealth and security than others. In short then, “[w]hat concerns them [neo-mercantilists] is precisely the international location of those economic activities that, in their judgement, contribute most to the political position and overall development of the economy” (Gilpin 1987:186).

Today, the high-tech sector is regarded as the far most important for ensuring both wealth and power. It is seen as the primary source of growth and comprises expanding export markets. Moreover, much technology is “dual use”, i.e., it has both military and commercial applications. Hence, as high-tech industries may have direct effects on the defence industry, it is crucial to keep them on national hands and be a frontrunner in research and development.

Neo-mercantilists often make two more general arguments for what sectors to protect. The traditional infant industry argument claims that protection is warranted for new firms that have little chance of competing head-to-head with already established companies. Protection, then, gives the industry time to “grow up”. Today, the argument is mostly used to defend protection of developing country firms in the international arena. It is, however, still used from time to time in the Western world as well. The argument does not point to any particular sectors that governments should target, but by extending the above argument, it is likely that high-tech ones will come high up on the list. A parallel, but opposite, situation is the one of “senile” or mature industries. There are arguments in favour of protecting industries that are no longer able to compete internationally on even terms if these industries are vital to national security, or if their disappearance could have major effects on social stability due to, e.g., massive unemployment.

A relatively new strategy related to neo-mercantilism is strategic trade policy. It challenges the traditional trade theory (and liberalism) by asserting that an activist trade policy can benefit countries more than a policy of free trade (Krugman 1986). It can be defined widely as policies that promote exports or discourage imports in particular sectors, especially high-tech industries (Krugman and Obstfeld 2000:ch.11). There are two main arguments that can be found in the economics literature in favour of strategic trade policy: Firstly, if there are substantial positive externalities (i.e., benefits that accrue to parties other than the firms that produce them), supporting the industry can yield large benefits to the whole country. Secondly, in some industries there are only a few firms in effective competition, making the actions of the parties “strategic”. In such oligopolies, individual firms can affect price significantly, which yields excess economic rents. There will be international competition over who gets

the rents, and governments can, it is argued, alter the rules of the game to the advantage of domestic firms (*ibid.*). Hence, using the terms from above, strategic trade policy is “malevolent”.

Several practical implications for neo-mercantilist international economic policy can be derived from the above discussion on goals and strategies. Firstly, access to domestic markets must be blocked or at least made more difficult. Traditional tools for achieving this include tariffs, non-tariff barriers, quotas, and export subsidies. If the goal is only to assure that there is a basis for domestic firms to engage in an industry (i.e., “benign” mercantilism), this may suffice. If, on the other hand, one has more ambitious goals, a next step would be to subsidise – e.g., through direct financial support or tax breaks – one or a few specific national firms to increase their market shares and profits domestically. That would give them a better position when competing in the international arena. As will be argued below, competition policy may also be used as a tool for strengthening a country’s wealth and security. Before that, however, a discussion of theoretical weaknesses of neo-mercantilism is warranted, as they may have important policy implications.

A first issue regards the measurement of success. Although not seen as a problem by many neo-mercantilists, Gilpin (1987:47) has admitted that the quests for wealth and power can often be more incompatible than generally assumed. Prioritising the latter could result in economic inefficiency in liberal terms. As such, this is not a problem, since the neo-mercantilist success criteria of a political action is not welfare maximisation *per se* but rather enhancement of “social ‘efficiency’ by wider, more valid, criteria” (Jones 1986:70). What *is* a problem is that neo-mercantilists have not specified what criteria should be used and what aspects it should include, besides the broad goals discussed above.

Secondly, even if the neo-liberal economic framework were applied, it can often be difficult to assess costs and benefits of intervening with the free market through industrial policy. Without this framework, it is destined to be even harder. Hence, what sectors are targeted will, therefore, be somewhat arbitrary and based on perceptions of what are important industries rather than objective facts. By opening up the rather naïve neo-mercantilist understanding of national interest, it is possible,

however, that the arbitrary selection of industries and lack of clear success criteria should rather be seen as an arena for actors with vested interests in an industry who consider the prize of protection open for grab.

Thirdly, and related to the second point, while the international distribution of gains gets much attention from neo-mercantilists, the *internal* distribution is largely neglected. Using the terms of neo-liberalism, if not its theory, it is clear that industrial policy benefits the producers – and in some cases the government as well – at the cost of the consumers. Moreover, the more protection the producers get, i.e., the closer they are to a monopoly situation, the higher the economic rents. In most cases total welfare in society will decrease. There may be exceptions if strategic trade policy works according to the textbook, but as argued earlier, this rarely happens.

The main point of the discussion is that *the weaknesses of neo-mercantilism may facilitate more neo-mercantilism*. The ambiguity of the criteria for both picking winners and assessing success, together with the clear incentive for producers to frame their needs as national, should result in *more* neo-mercantilist behaviour than if the criteria were clearer. Industry actors will attempt to frame their interests as important for national security and future growth, and hence come under the protective governmental umbrella, where politicians may be more than willing to welcome them.

Neo-mercantilist Prescriptions for Competition Policy Institutions

In a “neo-mercantilist world”, there would be no separate competition agency. Rather, the competence to review mergers would lie with the government departments that are responsible for promoting national security and competitiveness. This would facilitate the effective use of merger regulation as an industrial policy instrument. To the extent that external pressure (e.g., systemic push in the direction of liberal values and goals) makes it necessary to establish a separate agency, it should remain in the line of hierarchical control and oversight by the central administration and have many contact points and frequent interaction with the rest of the government. The staff should have a broad understanding of how firm actions affect both an industry and the economy more generally, and have broad discretionary powers to intervene in markets to

promote national interests. Its decisions should, moreover, be subject to review not by independent courts but by members of the government.

2.2.4 Between the Extremes: Ideas and Interests under Limited Autonomy

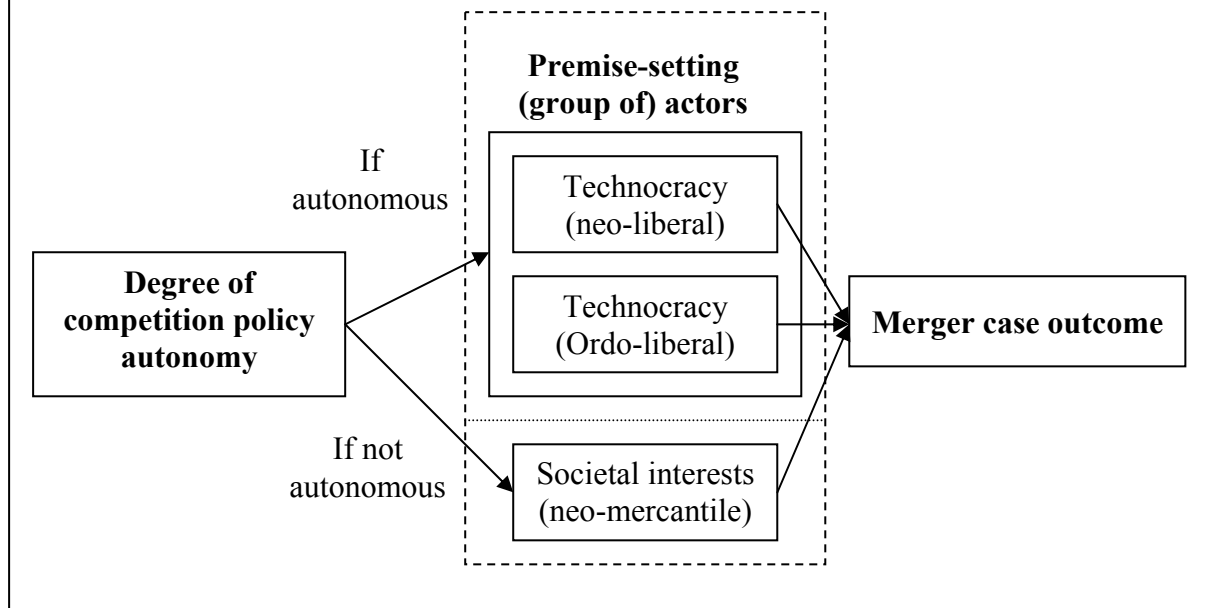
As argued in section 2.2.1, the degree of autonomy can be seen as a continuum between full and no autonomy. Thus far, the two extremes have been discussed. Any position between them, i.e., *some* degree of autonomy, would increase the strength of the competition authorities without excluding the possibility that other actors may also have a say. If that is the case, it is not unreasonable to assume that outcomes in general will reflect liberal ideas, but that in cases that mobilise pressure-groups beyond what is common, special interests may set the premises for outcomes. Which actors can be expected to have this kind of influence and what interests they would advance, was discussed in the previous section.

2.2.5 Linking Ideas or Interests with Merger Case Outcomes

Above, the degree of competition policy autonomy was used as a point of departure for discussing two different strands of explanations for how merger outcomes are set. The idea-based approach focused on technocrats making decisions informed by some version of liberalism; the interests-based approach saw outcomes as results of battles between pressure groups – in particular, state departments and politicians with neo-mercantilist interests were seen as being able to challenge (lower-level) competition officials as central premise-setters. The two strands of explanation are summarised in Figure 2.1. Although not shown in the figure, the paths may intersect if there is *some* degree of autonomy, making the outcome even less certain than in the “extreme” situations.

The last link, between premise-setters holding certain ideas or interests and merger case outcomes, is hitherto not examined in enough detail to be useful to the analysis of mergers. In order to reach a clearer understanding of the implications for merger reviews of each strand of explanations, the three theories of political economy must be operationalised. Below, each will be discussed in turn; in Section 2.2.6, they will be compared directly on central features.

Figure 2.1. Explaining Merger Case Outcomes



While both versions of liberalism acknowledge the importance of free market competition, it will be shown that they differ on key aspects when it comes to how mergers are assessed. In particular, the weight neo-liberalism puts on competition only as a means to achieving efficiency leads it to take a more lenient approach to what mergers should be blocked than what Ordo-liberalism does. The latter is concerned with maintaining competition *per se* and is thus more inclined to prohibit mergers that harm the competitive process, even if they may be (narrowly defined) welfare-increasing. Neo-mercantilism would, on its part, take an opportunistic position and prescribe approval for transactions that strengthen the relative position of a country and prohibition of deals that produce the opposite result.

As was the case with the general presentation of the theories, key economic models and concepts, which will subsequently be used in the case studies, will be explained and discussed in the section on neo-liberalism. The level of detail will thus be greater than in the sections on Ordo-liberalism and neo-mercantilism.

Neo-liberalism and Merger Regulation

Mergers can be divided into three categories, according to the relationship between the merging parties. If they operate on the same market, it is horizontal; if they stand in a

buyer-seller relationship, it is vertical; all others are called conglomerate. As will be discussed below, each could have positive and negative effects on efficiency. If the gains are greater than the costs, it is approved, and *vice versa*.

Before the effects on efficiency can be analysed, however, competition authorities must define the relevant market in terms of products and geographic extension as well as the degree of concentration in that market. Although economic theory has never fully answered the question of how to define a market, most scholars agree that it should be based on the possibilities for substitution in both consumption and production. Explains George Stigler (1955:4, quoted in Viscusi et al 2000:144):

“An industry should embrace the maximum geographical area and the maximum variety of productive activities in which there is a strong long-run substitution. If buyers can shift on a large scale from product or area B to A, then the two should be combined. If producers can shift on a large scale from B to A, again they should be combined.”

Analysing the effects of a merger in different markets almost amounts to analysing different mergers altogether. E.g., if the markets affected by a merger are purely national, the effects of a transaction in one jurisdiction may differ significantly from the effects in another. This renders it irrelevant to compare outcomes across jurisdictions. This is, by design, not a problem in this thesis, as only mergers in which the competition authorities use identical market definitions will be analysed²³.

To get a rough indication of the effects of a merger and whether it needs to be scrutinised further, industry concentration is typically measured before a proper analysis is conducted. To be useful to competition authorities, a concentration index should measure a firm's ability to charge a price above marginal cost. The one most widely used is the *m*-firm ratio, which measures the total industry sales of the *m* largest firms. It does not, however, grasp differences in size distribution among producers²⁴. The Herfindahl-Hirschman Index (HHI) is constructed in such a way that it does²⁵, and both the absolute HHI value of the post-merger market as well as the increase

²³ Adjustments in market definitions may of course be used strategically to facilitate a specific outcome. It is easier, for example, to block a merger by applying a narrow definition and *vice versa*. Comparing market definitions could as such be worthwhile a study, but it is outside the scope of this thesis.

²⁴ Consider, e.g., four-firm concentration ratios of two different markets. The percentages of sales of the four largest firms are, respectively: 20+20+20+20, and 65+5+5+5. The ratio is 80 in both markets, but the opportunity for charging a price above the competitive is, *ceteris paribus*, clearly greater in the second market.

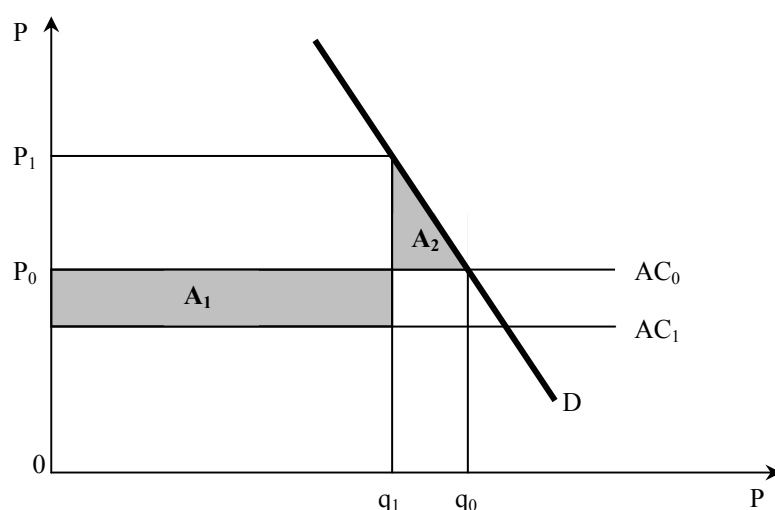
²⁵ HHI is formally defined as $HHI = (100s_1)^2 + (100s_2)^2 + \dots + (100s_n)^2$, where s_i denotes firm *i*'s proportion of total industry sales (i.e., its market share) and *n* equals the number of firms (Viscusi et al 2000:147-8). Consider again the example given in footnote X: The HHIs for the two markets are, respectively: $20^2+20^2+20^2+20^2=1600$, and $65^2+5^2+5^2+5^2=4300$. Hence, the HHI reflects the different degree of concentration in the two markets.

following from the merger can help indicating whether it is “problematic” or not. What number values should be considered “critical” will be discussed in Section 3.5.1.

Horizontal mergers

Horizontal mergers can have two sorts of effects on competition: Firstly, the integration of the merging firms’ productive facilities raises the possibility of cost savings (including the aforementioned economies of scale and learning curves, capital cost advantages, and joint R&D activities). This is shown in figure 2.2, where AC_0 represents the total average costs of both firms before a merger, and AC_1 the average costs after. There are socially beneficial economies of the combined operations equal to the area A_1 . Taking cost savings into account in this way is often referred to as the “efficiency defence” in merger reviews. Secondly, the merger reduces the number of competitors in the market. The merged firm may be left with (some degree of) market power, leading to an increase in price from P_0 to P_1 and a reduction in quantity produced from q_0 to q_1 . This results in a deadweight loss in consumer surplus equal to triangle A_2 . As should be clear then, the two effects of decreased costs and increased concentration from a merger may be conflicting²⁶. In some mergers, only one of the two arises, making the welfare implications of a merger clear. If both effects are

Figure 2.2. Benefits (A_1) and Costs (A_2) to Society from Horizontal Merger



Source: Williamson 1968:21

²⁶ In perfect competition equilibrium, both allocative and distributive efficiencies are maximized. Relaxing the assumptions of for example absence of scale economies, as done here, may result in the increase of one at the cost of the other.

present, they have to be weighed against each other – a case known as the Williamson trade-off model (Williamson 1968)²⁷. Although this specific model is valid only for horizontal mergers, the trade-off principle is highly useful when examining vertical and conglomerate cases as well²⁸.

Vertical mergers

Vertical mergers may also have both negative and positive effects on economic surplus. Three kinds of harm will be discussed. The first worry is with market foreclosure. For foreclosure to create anticompetitive problems one or both levels involved must possess some degree of market power and there must be barriers to enter the industry. The general claim is then that a merger will heighten the barriers to entry because a potential entrant faces a smaller “open market”. Moreover, if a firm were to enter both markets simultaneously, capital requirements could be greater (Williamson 1971; Comanor and Rey 1997).

Secondly, under certain conditions, a vertical merger might also raise the costs of rivals. Consider a competitive input market. One firm merges with a buyer of the inputs, and continues to sell the product (internally) at a price equal to marginal cost. If the structure of the input market changes by the loss of the merging firm and gives the remaining firms market power, they can charge a higher price. On the output level, this will raise the costs of the rivals to the integrated firm, and possibly drive them out of the market (Salinger 1988; Ordover et al. 1990).

Lastly, vertical integration, combined with high concentration at one level, may permit an extension of that market power to the other level. If a firm with monopoly on the input level raises the price of that input when selling it to rivals but without increasing the price of the final product similarly, a price squeeze results (Tirole 1988:195).

²⁷ Originally, Williamson (1968) showed that a rather small cost cut would outweigh a large loss in consumer surplus. Later versions of the model have shown that greater cost savings are needed if there is pre-existing market power. Furthermore, over time, many economies can be realized through internal expansion, so that the merger simply speeds up the process without creating additional gains (Viscusi et al 2000:200-203).

²⁸ A practical problem consists of quantifying the effects on efficiency (A_1 and A_2) from a merger. It would require hard facts to an extent that may not be available. Cost savings would be particularly difficult to estimate. Firstly, such effects are highly uncertain. Secondly, the competition authorities would have to rely on information from the merging firms, which will be inclined to overstate the savings to make a better case for themselves. This problem exists not only for gains from horizontal mergers; vertical and conglomerate cases raise similar difficulties.

Some arguments speak in favour of vertical mergers as well. Here, three benefits will be discussed briefly: reduction in transaction costs; elimination of double marginalisation; and exploitation of technological economies. Transaction costs are, to put it simply, “the cost[s] of using the price mechanism” (Coase 1937:390). They include, *inter alia*, the costs of finding a supplier or buyer, negotiating the specific terms of the deal, signing the contract and supervising it. These costs must be compared to the costs of producing the good or service internally. If the transaction costs are greater, it will be efficient for firms to merge (Coase 1937, 1991; Williamson 1984). Secondly, the problem of double marginalisation arises where firms on two successive levels in the value chain have market power. Each will charge a price greater than marginal cost to maximise its profit. If these firms were vertically integrated (e.g., through a merger), output would increase, price would decrease and both producers and consumers would benefit (Spengler 1950). Lastly, technological considerations may strongly speak in favour of vertical integration (Williamson 1984). A classic example is the integration of the production of iron and steel: Physical proximity would remove the need for reheating the iron before turning it into steel.

Conglomerate mergers

In this sub-section, some general considerations about the effects of conglomerate mergers on efficiency will be made. Then, so-called portfolio effects, which will be highly relevant for the case studies, will be discussed at some length.

Generally, a conglomerate (created through a merger) could potentially enhance efficiency by serving effectively as a “miniature capital market”. The top management of a firm has access to information and can change its operations; banks and stockholders are, on the other hand, much further removed from the internal operations of the firm (Viscusi et al 2000:214). Moreover, in a conglomerate, capital will be exposed to internal competition (Williamson 1975). Hence, conglomerate organisations may be superior to the capital market in allocating investment funds. In addition, transferring management expertise from the better-run firm to the other may produce efficiency gains.

The most serious anticompetitive effect is to eliminate a potential competitor. As described earlier, if the threat of entry is real, a firm cannot charge a price (much) above marginal cost without attracting new firms to the market. By removing the competitor by merging with it, the threat is eliminated and the firm can enjoy excess rents (Viscusi et al. 2000: 215-6). Two further anticompetitive effects can arise from conglomerate mergers: reciprocal dealing, i.e., the practice of buying from a supplier only on the condition that the supplier buys from you; and predatory pricing, i.e., the practice of cutting prices below marginal cost to drive out rivals (or to deter future entry), at which point prices again can be raised to a level where the firm makes a profit (and at the extreme to monopoly level) (ibid.). It should be noted that these practices are confined neither to mergers nor to conglomerates.

The past few years, emergence of both relevant merger cases and new economic theories has drawn attention to so-called portfolio effects in conglomerate mergers²⁹. The OECD (2002:23) defines portfolio effects as pro- and anti-competitive effects that may arise when combining products (1) in which one or more parties enjoy market power, but not necessarily dominance, and (2) which are sold in neighbouring or related markets. The relevance for merger regulation is that such mergers could facilitate tying or bundling. Tying is the practice of conditioning the sale of one product on the sale of another. Bundling involves selling two or more products as a package and exists in two versions: pure bundling, i.e., the products are *only* sold as a package (which for the purposes of this thesis could be equalled to tying); and mixed bundling, i.e., products are sold both separately and as a bundle, with the package price below the sum of the individual prices. Although such practices can be arranged between independent firms as well, a merger facilitates their use by reducing the transaction costs of negotiating and supervising them (ibid:27).

One positive aspect of tying or bundling arises from the Cournot effect: When two firms with some market power merge, they will have the incentive to internalise a pricing externality: By lowering the price of one product they will increase the demand for the complementary product as well (and *vice versa*) (Cournot 1838/1995). This

²⁹ Other concepts that are occasionally used to describe this phenomenon are range effects or simply conglomerate effects.

results in increased profits for the firm and lower prices for both goods to consumers³⁰. Other benefits arise from reduced transaction costs when purchasing complements from the same seller (“one-stop shopping”) and the aforementioned scope economies.

Tying or bundling can also be used to price discriminate between consumers. By charging different prices to different customers for the same goods according to their willingness-to-pay, firms can extract some of the consumer surplus as profits. This has ambiguous welfare consequences. On the one hand, it may increase output by serving consumers that would otherwise have been excluded from the market; on the other, consumers with relatively inelastic demand will likely face a higher price if price discrimination occurs (Pindyck and Rubinfeld:ch.11).

Conglomerate mergers involving portfolio effects could also lead to post-merger tying or bundling that has the negative effect of foreclosing markets for potential competitors. The economics literature has traditionally asserted that monopoly profit can only be taken once, i.e., a monopoly producer of good A cannot increase its profits by tying the sale of A to a competitively priced product B ³¹. Although this still holds in most cases, economists have recently shown that exceptions may occur when the second market is less than perfectly competitive: Foreclosure through tying and bundling could be used both to leverage market power from one market to another (Whinston 1990; Nalebuff 1999) and to consolidate market power where it already exists (OECD 2002:32-3).

Nalebuff (1999, 2000) has shown that it is also possible that tying or bundling could harm buyers by reducing the profitability of entry into any one of a number of products sold together: “Although creating a bundle doesn't stop competition, it forces competitors to play the game bundle against bundle. A firm that has only some components of a bundle will find it hard to enter against an incumbent who sells a package solution at a discount” (Nalebuff 1999:32). If bundle-against-bundle

³⁰ The efficiency benefit from this internalization is analogous to the elimination of double marginalization through vertical integration.

³¹ This general notion has led Chicagoans to strongly oppose that there is any need for competition authority intervention in conglomerate mergers (see, e.g., Director and Levi (1956) and Schmalensee (1982) for a more formal argument). This conclusion has proven to be hard-wearing, which can help explain why there was little or no theoretical development on conglomerate mergers until the 1990s.

competition *does* take place the welfare effects are unambiguous: Consumer surplus increases at the cost of producer surplus.

From this discussion, it should be evident that portfolio effects in conglomerate mergers could be both pro- and anti-competitive. Although it is difficult to assess when and to what extent each effect comes into play, the OECD (2002:37-8) has constructed a trajectory of seven steps, which must be fully completed, in order for a conglomerate merger to actually have a net detrimental effect on consumers:

- the merged firm will enjoy such significant internalised complementary pricing (or analogous) effects and/or efficiencies from the merger that it finds it profitable to drop prices below premerger levels in at least one market whether or not it expects that price drop to induce competitors to exit (i.e. the price drop cannot be prohibited as predatory pricing);
- neither rivals nor new entrants can match the merged firm's new costs;
- rivals will exit;
- buyers cannot use countervailing power to hold prices at or below pre-merger levels;
- firms will not enter or re-enter the market in response to price increases above pre-merger levels;
- the merged entity finds it profitable to raise prices above pre-merger levels;
- and what buyers initially gain through prices set below pre-merger levels is less than what they later lose through paying higher than pre-merger prices.

Hence, the task becomes one of weighing the relatively more certain immediate gains from the merger against more hypothetical longer-term losses due to exit and foreclosure effects. The OECD (2002) stresses throughout its report that this is a very difficult exercise and that it is unlikely that there will be many mergers of this type that should be prohibited, a position supported by Viscusi et al. (2000:242).

Ordo-liberalism and Merger Regulation

A well-functioning competition law is fundamental to Ordo-liberalism. Although all laws are expressions of and offer support to the economic constitution, competition policy has direct responsibility for creating and maintaining complete competition. Other policies would be ineffective if the basic market conditions were flawed. It should be noted that since Ordo-liberalism was founded in the 1930s and that key features of the theory were developed in the subsequent couple of decades, it was also based on the economic thinking of the day. Moreover, the focus of the writings was on monopolies and cartels, not on mergers. Informed by the basic goals and principles identified in the general discussion of Ordo-liberalism as well as the opposition to

monopolies, however, it should be possible to examine what would be its prescriptions for present-day merger policy challenges.

To briefly revisit the goals debate from Section 2.2.2, the main objective of competition policy in Ordo-liberalism is to protect individual economic freedom of action *per se* and, equivalently, limit undue private economic power. In other words, competitive market structures have value in themselves and must be maintained. Economic efficiency will generally result as private agents act on the incentives created in the market, and could as such be seen as an indirect and derived goal (see Möschel 1989). There may, however, be cases in which the two conflict. These instances, which will also highlight the differences from neo-liberalism, will be of particular interest in the discussion below. First, however, it is instructive to consider the Ordo-liberal opposition to monopolies.

Monopoly positions cause worries as their very existence is incompatible with a competitive order. Cartels and similar agreements between competitors are seen as particularly damaging and should be prohibited *per se*. How to treat single firm monopolies is less clear-cut. If the position is obtained by offering superior products at lower prices, for example, it is a result of the competitive process and consumers have gained from the process. Even in these cases, however, the concern for maintaining competition requires such monopolies be broken up through divestitures or other means (Böhm 1933).

As explained in the section on neo-liberalism, mergers change market structures in the direction of greater concentration. Where the transaction takes place in a dispersed market between firms that have little or no market power, no worries are warranted. In other cases, the structural conditions for competition may be at stake.

For the freedom to engage in competition to be realistic, the barriers to enter a market must be low. It is thus reasonable to assume that Ordo-liberals would apply a very broad definition of what are considered to be barriers. The evaluation of efficiency gains is particularly interesting. On the one hand, such gains increase welfare; on the other, they make it more difficult for newcomers to enter a market. Being results of the competitive process they should be welcomed, but only when the firms generating them are small and without market power. In the hands of dominant

firms, economies become barriers, and given the priority of unrestrained market access, they will count against a merger (*efficiency offence*). Moreover, even moderate foreclosure effects from vertical or conglomerate mergers will be viewed negatively as potential entrants face a smaller open market.

Actual competitors must also be protected from the power that firms may gain from a merger, which may otherwise be used to restrict or even exclude rivals from the market. Thus, efficiency gains will count against a merger not only if they harm potential competitors, but also if they make the parties to a deal so competitive that they can outdo their existing rivals. This would impede the freedom to compete and even destroy the competitive process as such.

Lastly, Ordo-liberals would be concerned with size *per se*, particularly if a firm possesses large financial resources. The fear is that such firms, which often are created through conglomerate mergers, will be able to dominate not only the economic sphere, but that such resources may be used to obtain political influence as well.

Neo-mercantilism and Merger Regulation

As the use of protective measures such as tariffs becomes ever more restricted through, e.g., bilateral free trade agreements or the World Trade Organization, governments should, according to neo-mercantilism, look for other ways to protect industries that are considered particularly important to national wealth and security. Merger regulation could be used to further both benign and malevolent policies in a quite straightforward way. Defensively, one can imagine that a government may allow, or even encourage, mergers to help a firm or industry survive in the face of foreign competition, despite negative impact on efficiency. A more aggressive stance is taken if a firm is awarded a (close to) monopoly position in its home market to enhance its capacity to compete internationally, which may again give the country a comparative advantage in an industry over time. Such firms are sometimes called “national champions”.

A particularly interesting situation exists in the case of *multi-jurisdictional* mergers. In these cases, a merger between two companies in one country can be blocked or significantly modified by the authorities in another. This obviously

provides a country with the opportunity not only to support its own companies but also impede the competitors³². In the special case of *cross-border* mergers, the chance that the gains will be somewhat evenly distributed is greater. If, however, one of the firms is dominant, most of the R&D activities are likely to be undertaken in that country (Pauly and Reich 1997). Similarly, any other unequal distribution of gains emerging from the merger will likely provoke a prohibition by the authorities of the losing country, even if the firms as a merged entity could gain in an absolute sense.

Merger decisions motivated by neo-mercantilism will also have implications for the *internal* distribution of gains. A merger between two foreign firms may increase competition in the market, reduce prices and hence increase consumer surplus in the home country. Thus, total welfare in the society may increase if this gain is greater than the loss in producer surplus for domestic firms. This does not matter, however, given that policy is determined by the effects a merger has on producers. Thus, if it takes a monopoly at home to compete abroad, the loss in consumer welfare is seen as a necessary price to pay.

In summary, some characteristics of firms and industries make a merger more prone to neo-mercantilism. Firstly, the concern with relative gains will become stronger if it is clear who wins and who loses. This will be the case the fewer are the competitors in an industry (with the extreme case of a merger reducing an industry to a duopoly), and if the merger is between two companies from the same country rather than a cross-border one. Secondly, some industries are more sensitive than others, in particular the ones involving high-tech and defence production. Moreover, governments are unlikely to allow a foreign firm to merge with, not to mention acquire, a domestic firm in such a sector. Infant and senile industries may also provoke neo-mercantilist actions, while sectors that are likely to produce significant positive externalities are good candidates for strategic trade policy. Thirdly, governments may be taking actions due to the impact a merger has on labour. The loss of jobs will be felt

³² A special case could arise due to the weight on relative gains and losses: A country *A* may attempt to block a merger in another country *B* even if its companies do not lose directly from it. The point is that *B* becomes wealthier if the merger goes through (e.g., from gaining market shares from companies from third countries), and the relative position of *A* may deteriorate.

more directly than the creation of new ones; hence, senile industries may pose particular concerns.

2.2.6 Analysing Merger Case Outcomes in Practice: Five Factors, Three Steps

Above, the three theories of political economy were operationalised with respect to their prescriptions for merger regulation. In moving from theoretical prescriptions to empirical analyses of merger case outcomes (Chapters 5 and 6), a two-pronged approach will be applied. Firstly, the official merger decisions, as set down by the competition authorities will be discussed. This will be done in light of how the decisions measure up against the five factors identified in equation (2) in Section 2.1.1. A comparison of how the political economy theories relate to the factors will be made below. The very selection of factors, however, implies a bias in direction of liberalism: They are important from a liberal point of view, but not necessarily if considered from another perspective. The second part of the approach to the empirical analysis adjusts for this challenge. Here, the process leading up to the outcome and the circumstances surrounding a case will be discussed. In particular, a three-step strategy to indirectly identify neo-mercantilism as a deciding factor – which will again have implications for the view that liberal ideas underlie an outcome – will be presented.

The Five Liberal Factors

It should be noted that while liberalism is indifferent to the origin of companies and what they produce when evaluating mergers, neo-mercantilism is not. The latter would, moreover, prescribe actions contingent on whether a transaction is to the benefit or detriment to the relative position of a country. For the sake of simplicity, only the case of benefit will be examined below.

(1) What and whose interests shall be protected or promoted when considering harm of a merger? In the neo-liberal model, the overall effect on society means more than the protection of any single group: As long as allocative efficiency is not reduced from a merger, the internal distribution of gains between consumers and producers, or between the merging companies and their competitors, is of no concern. Ordo-liberalism shares the concern for consumers, but is not neutral when it comes to firms: The worry for damage to the competitive process implies a bias against (large)

merging firms in favour of smaller competitors. Also, fear of spill-over from economic to political power implies a concern with size *per se* and even more so if a firm possesses large financial resources. Neo-liberalism would not make any such deliberations: As long as a merger does not reduce economic efficiency, it should be approved. Neo-mercantilism, on the other hand, takes a strong position in favour of the merging parties if undertaking the transaction can strengthen them, and thus the country, in the competition against foreign firms and states. This could mean awarding them a monopoly position in the domestic market to the detriment of consumers.

(2) *What is considered as an entry barrier* and (3) *how are efficiency gains assessed?* As discussed above, it is not entirely clear what is encompassed in the neo-liberal definition of barriers. It would, however, centre on those that are efficiency-reducing. Ordo-liberals, on the other hand, would be more inclined to consider efficiency-enhancing effects negatively, as they may reduce potential competition if the firm generating them holds a dominant position. The other aspect of efficiency gains, i.e., their effect on *actual* competition, would also divide the two versions of liberalism: Neo-liberals would use them as a defence for the merger, even if it means that competitors will be outdone; Ordo-liberals would take the opposite position and only approve of such gains when the firms producing them are small and without market power. Paradoxically, such firms do not need an efficiency defence.

Foreclosure effects from vertical or conglomerate mergers would also generate different positions, at least to a degree: In neo-liberalism, they would have to be large to trigger a decision against a merger; for Ordo-liberals, even moderate foreclosure effects would be deemed harmful as new entrants would face a smaller open market.

Neo-mercantilism would take a pragmatic approach to both issues. Efficiency gains would be endorsed as they would help increasing the wealth and competitiveness of the country as compared to another. Barriers would, similarly, be regarded as positive if the firms being kept out of the market were foreign.

(4) *What time perspective is taken when considering the effects of a merger* and (5) *in cases of doubt, is ex ante or ex post regulation preferred?* The two versions of liberalism have somewhat different views on market processes. The importance of maintaining competition not only for the sake of economic efficiency but also for its

implications for political, economic, and social freedom would make Ordo-liberals favour a rather cautious handling of merger cases. Thus, if there are doubts about the effects of a merger it is better to block it than to risk that a firm gains coercive power that will impede the freedom of others. This again has two consequences: Firstly, *ex ante* rather than *ex post* regulation is preferred; secondly, if the longer-term effects of the merger are suspected to be anti-competitive it should be prohibited even if the more certain short-term gains may be positive and to the benefit of the society.

Neo-liberals, on the other hand, display more faith in the self-regulatory capacity of the market. Thus, if the effects of a merger are ambiguous, or the short-term consequences are positive while the longer-term results *could* be negative, it should be approved. The market is considered to be able to take care of any small distortion itself, and in the worst case, the competition authorities can correct any failures at a later stage.

Neo-mercantilism would prescribe a concern for both the short- and longer-term effects of a merger to the extent that the deal could give domestic firms an advantage to the detriment of foreign ones. An interesting additional aspect of this is given by the neo-mercantilist belief that comparative advantages could be *created*. As it may take several years to build up a dominant position in an industry, the long-term effects may be counted in to an even greater degree than in Ordo-liberalism.

In total, each of the three theories of political economy would prescribe certain values on the five factors just discussed. Neo- and Ordo-liberalism take different stances on all; thus, analysing decisions in light of these factors will distinguish well between the two versions of liberalism. The neo-mercantilist position, which reflects how a merger affects a country's relative position, overlaps each of the other theories on some factors. There is thus a need to go beyond the decision as it stands and look at the whole review process and surrounding circumstances more closely.

The Three-step Neo-mercantilist Approach

To discuss whether neo-mercantilism has been in play, which simultaneously strengthens or weakens the claim that any version of liberalism has been used, it is not enough to merely regard the official arguments – they will practically always be put in

liberal terms. It is also necessary to study the circumstances surrounding the decision. First, though, one crucial assumption must be made: A country using a neo-mercantilist rationale will be considered as a “cheater” under the current politico-economic paradigm, and may be punished directly through retaliation in other merger cases or in different policy areas, or indirectly through condemnation, loss of international reputation, and higher transaction costs for future cooperation. It is thus likely that neo-mercantilism will be used only in cases that are considered by decision-makers to be important to a country’s interests.

Based on this, a three-step operationalisation can be suggested. The first step would be to discuss whether the merger is a “likely case” for neo-mercantilism. Although it is difficult to quantify what cases are “important”, certain aspects, as discussed in Section 2.2.5, would make interference more likely: (1) There are clear winners and losers from the merger, something which becomes more visible if the merging parties are from the same country, their main competitor(s) are from the other, and there are few firms in the market; (2) the merger takes place in a key industry, i.e., defence and high-tech sectors (including “infant” industries) and industries facilitating strategic trade policy; and (3) there are substantial effects on labour, typical found in “senile” industries. The second step would be to demonstrate that there are “flaws” or inconsistencies in a merger decision from the perspective of any version of liberalism (i.e., a *negative* definition of neo-mercantilism). Lastly, one should discuss whether there is a pattern of circumstantial evidence that supports such a theory, or if there are empirical facts speaking against the proposition. This should be organised around the “access points” for neo-mercantilist influence that will be subject to empirical discussion in Section 3.7 of the next chapter.

Some concluding notes should be offered on the appropriateness of this approach. Hellevik (1991:43) argues that the overall validity of data is given by two factors: how clear and precise operationalisations are; and how reliable the collection of data is (see further discussion in Section 2.4.2). The problems resulting from a bias in favour of liberalism were discussed above. The proposed solution is to “open up” the dependent variable and first analyse a given case according to five factors that are, implicitly or

explicitly, present in any merger decision as set out by competition authorities, and then to investigate the case from a broader perspective in three steps. Going through several factors and steps has a significant positive impact on both elements of data validity: Reliability is increased as an imprecise measurement of one element will have less extreme effects than if a single factor/step were assessed; in addition, validity is improved as more aspects of the of the arguably multi-faceted outcome are included.

2.2.7 Comparing the Theories of Political Economy

Table 2.1 provides a summary of the general features of the three political economy theories as well as their stance on the five liberal factors discussed in Section 2.2.6.

Table 2.1. Comparison of Neo-liberalism, Ordo-liberalism and Neo-mercantilism

| | Neo-liberalism | Ordo-liberalism | Neo-mercantilism |
|---|---|---|---|
| Overall goal(s) | Maximise economic efficiency | Individual liberties, but also efficiency and social equity | Protect/strengthen national security and wealth |
| Key actor(s) | Private economic agents | Private economic agents, but need state | State and large firms |
| Role of government | Correct market imperfections | Maintain competition; (some degree of) welfare redistribution | Power and wealth accumulation |
| Task of merger regulation | Correct market failure | Maintain competition/avoid dominance | Industrial policy instrument |
| Design of competition institutions | Independent agency, judicial review; economics-driven | Independent agency; judicial review; law-driven | Part of central government; politics-driven |
| Beneficiaries of merger regulation | Society in large | Individuals/consumers and non-dominant firms | State, producers |
| Entry barriers | Narrow definition | Broad definition | Whatever protects domestic firms |
| Efficiency defence? | Always | Only if benefiting consumers/small firms | Only if benefiting domestic firms |
| Time perspective | Shorter-term | Short- and longer-term | Short- and long-term |
| Ex ante/ex post regulation | Ex post | Ex ante | Ex ante |

2.3 Between Covering Law and Description: Middle-range Theorising

Competition policy is, as mentioned above, a field of study that has been largely neglected by political scientists. Thus, much of what has been done so far has focused on concept formation and, to some extent, theory development. The explanations of merger case outcomes offered in this thesis are of the middle range. Middle-range theories constitute an intermediate position between description and covering law, as they “lie between the minor but necessary working hypotheses that evolve in abundance during day-to-day research and the all-inclusive systematic efforts to develop a unified theory that will explain all the observed uniformities of social behaviour, social organization and social change” (Merton 1949/1968:39).

One reason why it is unlikely that one may succeed in formulating a general (covering) law and specifying the conditions that make the law applicable in a certain case is the often complex relationships that exist between the elements of an explanation. Ragin (1987) has pointed to two sources of causal complexity: On the one hand, the effect of any particular causal condition (e.g., whether technocrats or politicians determine an outcome) depends on the presence and absence of other conditions (e.g., to what extent a case triggers neo-mercantilist interests) (what Ragin calls “conjunctural causation”); on the other, several combinations of conditions may produce the same result (e.g., whether technocrats, politicians, or firms set the premises for a decision does not necessarily lead to different outcomes) (“multiple causation”).

One important implication of this complexity is that middle-range theories are often better at explaining social phenomena *post factum* than to predict outcomes (Mjøset 2002). This will be reflected in the discussion of the selection of case studies in Section 2.4.1.

2.4 Other Methodological Considerations

Two issues will be discussed in this section: the selection of case studies and the choice and use of sources.

2.4.1 Selection of Case Studies

Two merger cases will be analysed in detail in Chapters 5 and 6: the 1997 Boeing/McDonnell Douglas merger and the 2001 merger attempt between General Electric and Honeywell, respectively. The US approved the former unconditionally, while the EU required the undertaking of several remedies before it was allowed to go through. The latter case was approved in the US after the merging parties had agreed to some minor conditions while the EU blocked it altogether.

A question that is typically raised in *small N*-studies concerns how representative the cases are. Aiming at middle-range theorising, however, this concern is less relevant, as prediction is difficult and no broad generalisations will be made³³. This gives more freedom in the selection of cases, and responds to a warning raised by Ragin (1997:31) about the disadvantages of being too formalistic: “Researchers end up asking questions dictated by methods (...), not by their theoretical, substantive, or historical interest.”

Furthermore, a careful selection of representative cases is more relevant when theory is already well established and the aim is the rigorous testing of hypotheses (King et al. 1994; see also Rogowski 1995; Ragin 1997). As this thesis is more concerned with concept formation and theory generation, the criteria for selecting cases are different. In particular, three reasons for their selection can be given. Firstly, they are the two highest-profiled mergers in terms of cross-Atlantic disputes in the last decade – what Yin (1994:39) has called “extreme or unique case[s]” – and together they raise a wide range of questions that should help bring out any difference between the US and EU merger regimes. The reason why not only one, but two cases are selected is quite straightforward: Studying two different mergers produces more chances to analyse how and why outcomes are reached and why they differ between jurisdictions. In addition, the cases affect somewhat different aspects of the theoretical

³³ Not aiming for broad generalisations takes the sting out of two possible criticisms. The first concerns “selecting on the dependent variable” (see King et al. 1994:129-37). Although the dependent variable in the model is merger case outcome, whose complete range of values is examined, it could be argued that in terms of explaining why the US and the EU reach different outcomes, there is a clear bias by only examining cases with conflict. For a defence of selecting on the dependent variable in case-oriented studies, see Ragin 1997 and also Rogowski 1995. The second concerns the fact that both cases involve two US companies and that the industries in which they operate are similar. This could possibly have put a limitation on how far generalisations could be stretched. It should be noted that while the first is the result of conscious design (the cases are picked *because* of divergent outcomes), the latter is “by accident”: Had another case existed which involved two EU firms in a different industry, and still produced divergent outcomes, it would have been chosen. No such case exists.

framework, which broadens the base on which conclusions are drawn. Secondly, the cases pose a serious challenge to the official statements of the US and EU competition authorities that mergers are only reviewed according to a neo-liberal standard. If this is true, differences in outcomes must be due to different interpretations of evidence, which is an interesting finding in itself. If, alternatively, other standards or other goals are used, it is important that they are brought into light. As such, this strategy resembles a “strategic test” of the claim that all merger decisions are made according to a neo-liberal rationale, using two deviant cases (Eckstein 1975). Lastly, the case studies, and in particular the results from the strategic test, should facilitate an exploration into the usefulness and explanatory power of the theoretical model as such.

2.4.2 Sources and their Interpretation

The complexity of the merger case processes and the need to obtain reliable and valid data speaks strongly in favour of using multiple sources of evidence. Yin (1994:93) has argued that such data triangulation is crucial in the “development of *converging lines of inquiry*”. In this thesis, four kinds of sources are used: official documents, secondary literature, press reports, and interviews. Each will be discussed.

A central source of data is *official documents* (primarily) from the competition authorities: rules and regulations, statements of general policy, and material related directly to merger cases. Although highly informative, they must be read critically as they are always written for some specific purpose and for some specific audience. In particular, the bias in favour of liberalism must be taken into account. A special challenge is raised by the fact that the US competition authorities, unlike their counterparts in the EU, do not publicise a report stating the arguments for reaching their decision in a merger case. Thus, one is forced to rely on less detailed statements and speeches as well as other kinds of sources.

Newspapers and magazine articles as well as *news agencies and broadcasters* can provide important accounts of the dynamics of a case as they follow the day-to-day development of merger investigations closely. They supplement official documents in the sense that conflict is typically given more space than harmony; this bias must be kept in mind, though. In this thesis, press reports are used to a limited

extent in the case studies, together with other data. The use of only well-recognised sources like the Financial Times, the Wall Street Journal, the Economist, Business Week, Reuters, AFP, BBC, and CNN increases the chances, if not guarantees, that the information provided is reliable.

Academic sources have also been used. As discussed earlier, the political science literature on competition policy is limited, giving legal and to some extent economic accounts a more central role. The drawback is the extra work this has imposed on an author writing within a political economy tradition; the advantage is that the texts are typically more descriptive, giving room for “fresh” analysis rather than mere re-examinations of what has been done before. It should be noted that secondary literature has been used most extensively in the discussion of the competition regimes (Chapter 3) and little in the case studies (Chapters 5 and 6).

The various written sources have been complemented with in-depth *interviews* with 25 persons undertaken in Brussels and Washington, D.C., in June/July and October, 2002, respectively³⁴. Some were interviewed more than once; some were followed up by subsequent e-mail correspondence. Respondents were chosen for the central roles they occupy in the merger review process: A majority were competition officials from the EU and US agencies. In addition, representatives from the Secretariat-General of the European Commission, the US Senate Subcommittee on Antitrust, firms that had recently been involved in mergers (not those of the case studies, however), and counsellors representing firms in dealings with competition agencies were interviewed³⁵.

As the interviews were conducted relatively late in the process, at a point where the author had substantial knowledge on the topics, it was regarded as most productive to use what has been called a semi-structured strategy (Andersen 1990:143). In practice, this means that for each interview, the main topics and questions to be covered were put down in advance while allowing for open-ended answers, follow-ups, as well as interviewee-initiated “spin-offs”. With the broad concerns of this thesis,

³⁴ Half of the Brussels interviews were undertaken together with Professor Helge Hveem, project leader of “Globalisation as a Transformative Force”.

³⁵ In addition, the author met with the Minister-Counselor for Competition at the Mission of Norway to the EU, Ms. Nina Gørriksen, and the Minister-Counselor for Economic Affairs at the Norwegian Embassy in the US, Mr. Kristian Ødegaard, for general briefings.

stretching from general goals and procedures to the nitty-gritty of specific merger cases, it would not have been sensible – or practically possible – to discuss every issue with each respondent. Thus, their different expertise and roles in the merger process were exploited when focus was set. The same topics were covered on both sides of the Atlantic, and the ones that were most important were raised in several interviews. As the trip to the US came last, some additional questions were added based on information gathered in Brussels outside the original interview guides. One last issue should be addressed: Due to the sensitive nature of the issues discussed, no tape-recorder was used. What may have been lost in accuracy from taking notes was seen as a small cost compared to having a reserved and sceptical interviewee. This choice was indeed commended by some respondents. There were, moreover, strong requirements for anonymity from all the subjects. As some may be easily identified even by making it public that they have been interviewed, no respondents are mentioned by names.

Chapter 3. The US and EU Competition Regimes

The purpose of this chapter is to describe, discuss, and explain central features of the US and EU competition regimes. It revisits some central questions brought up in Chapter 2, this time at the formal level: How autonomous are the competition authorities? Where, if they exist, are the access points to the decision-making process for other (groups of) actors? What ideas are manifested in goals, laws, and regulations? Although there are many similarities between the two regimes, there are also important differences. In order to make them as explicit as possible, the regimes will be compared directly on each of the following topics: the legal foundations for merger regulation; institutional build up; goals; the substantive test used to make the decision on whether a merger should be approved or prohibited; and the procedures followed in the case analyses. Furthermore, a cooperation agreement entered between the competition authorities in 1991 will be discussed. Lastly, legal and institutional features that enable and facilitate divergence from the formal rules and procedures will be examined.

3.1 *Historical Roots and Legal Foundations*

Competition policy originated in the US at the end of the 19th century out of concern that the giant industrial trusts would swallow up their competitors and exploit their customers (which explains the US use of ‘antitrust’ rather than ‘competition policy’). The legal foundation for merger regulation is given in section 7 of the 1914 Clayton Act (15 U.S.C. §18), which was amended in 1950. It is the responsibility of the Courts of Justice (and especially the Supreme Court) to interpret the broad language of the law and fill it with more precise meaning. Thus, a substantial case law has built up over the years. In addition, the 1984 Non-horizontal Merger Guidelines and the 1992/1997 Horizontal Merger Guidelines, issued by the US competition authorities are important to understand US merger regulation.

EU competition policy has, for obvious reasons, a much shorter history. Still, it was clear to the founding fathers that the creation of a common – and later a single – market could not be successful without the simultaneous development of rigorous

competition rules (Gerber 1998; Cini and McGowan 1999). Hence, Articles 81 to 89³⁶ of the 1957 Treaty of Rome are concerned with a broad series of issues that can distort competition. There was no separate section on mergers, although the European Commission (hereafter “Commission” or “EC”) interpreted Articles 81 (on cartels) and 82 (on monopolies) widely enough to include the combination of firms. Moreover, the powers of the EC on this issue were extended several times by the European Court of Justice (Goyder 1998). Finally, Council Regulation 4064/89 “on the control of concentrations between undertakings” (hereafter “the Merger Regulation” or “MR”) was adopted in December 1989 and entered into force the following year. As will be discussed in the next section, the Commission does not have to take a case to court to challenge it. Hence, most of the European “case law” consists of old Commission decisions. Some of these decisions have been appealed to the EU courts, however, which have subsequently clarified important issues. In addition, the EC publishes interpretive notices on the MR on key topics.

Both the US and the EU have extended the reach of their competition laws beyond their borders through the extraterritoriality principle. The principle becomes relevant if business practices of firms in one country have an anticompetitive impact on another country which the latter considers to be in violation of its laws. The underlying notion is that a government should be able to protect itself and its citizens from being hurt by an action exercised abroad. The principle entered US case law with the 1947 *Alcoa* decision³⁷ while the European Court of Justice adopted a slightly less aggressive version with its *Wood Pulp* decision in 1985³⁸. Although still controversial, extraterritoriality is increasingly accepted world-wide as a basis for competition policy actions, and is generally approved of in both the US and the EU (see, e.g., Valentine 1997 for the US and Van Miert 1997 for the EC).

³⁶ The 1997 Treaty of Amsterdam renumbered the Articles. The numbers used here are the revised ones, and are equivalent to Articles 85-94 in the Treaty of Rome.

³⁷ *US v. Aluminium Company of America*, 334 US 100, 1947. In the decision, Judge Learned Hand stated that the US could apply its antitrust laws where foreign conduct had an “intended effect” in the US. Hence, the provision has become known as the “effects doctrine”.

³⁸ *A. Ahlström Osakeyhtiö v. Commission*, Case 89/85 1988 E.C.R. 5193.

3.2 Institutional Features

In the US, the authority to enforce the Clayton Act is shared between the Antitrust Division of the Department of Justice (DoJ) and the Federal Trade Commission (FTC) (jointly referred to as “the agencies”), which have roughly coextensive jurisdictions³⁹. The Antitrust Division, which is part of the executive branch, is headed by an Assistant Attorney General (AAG). He or she is appointed by the President, subject to Congressional approval, and leaves office with the change of Administration. The FTC, on the other hand, is an independent regulatory agency. It is lead by five Commissioners, also they nominated by the President and confirmed by Congress, but each serves a seven-year term and there can be a maximum of three members from one political party. Moreover, the FTC is financed by and reports on its actions to the Senate. Together with the role assigned to the courts (see below), this is a reflection of the system of checks and balances among the three branches of US government.

Which agency will review a particular merger is decided by informal discussions and based on previous experience with the industry or company. The investigation begins when the merging parties file their case. The responsible agency then has 30 days to make the decision of whether to clear the merger or to issue a detailed request for more information and documents (so-called “second request”). In case of the latter, the “clock stops” until the merging firms comply; thereafter, the agency has another 30 days to decide whether the transaction should be approved or not. The procedure to block a merger varies between the DoJ and the FTC: The DoJ brings the case before a Federal District Court to seek preliminary *and* permanent injunction; the FTC files a complaint before an administrative law judge as well as a Court action to seek preliminary injunction pending the administrative case. The decision of the administrative judge can be appealed by either party to the whole Commission, which rules based on simple majority voting. Court decisions can be appealed first higher courts and ultimately to the Supreme Court. Throughout the investigation, the merging companies can restructure their deal and suggest

³⁹ In addition to federal antitrust enforcement, the states also have the right to challenge any transaction that has a significant impact on commerce within their borders, even if the transaction is national or international. Individuals and corporations injured by violations of the antitrust laws also have the right to pursue cases, although this is mostly done in non-merger cases (Fox and Pitofsky 1997).

undertakings that can remedy the agencies' concerns, hence allowing the merger to proceed.

The EC Merger Regulation (art. 1) has conferred exclusive jurisdiction on the Commission over "concentrations with a Community dimension"⁴⁰. The authority to investigate and prosecute a merger has been given to the Directorate General (DG) for Competition, and more specifically to the Merger Task Force (MTF). The decision whether to approve or prohibit a merger rests with the Commission as a whole, although Phase I decisions (see below) are made by the Competition Commissioner on its behalf.

The merger review begins with a formal notification from the merging firms to the DG Competition, but pre-notification discussions on both procedural and substantive issues are common and often lengthy, in order to improve and speed up the formal process. From the notification, the MTF has one month (which can be extended to six weeks) to investigate the effects of the proposed merger. At the end of this period, the Competition Commissioner can decide to approve the merger with or without undertakings, or to initiate a Phase II investigation, which can last up to four months. During this time the MTF issues its Statement of Objections, which explains its opposition to the merger. It also holds an oral hearing, where both the merging parties as well as interested third parties can participate. The Merger Regulation also stipulates that an Advisory Committee, consisting of representatives of the competition authorities of the EU member states, shall comment on the case. Its conclusions are not legally binding for the EC, but shall be taken seriously into account. The final decision is made by the College of Commissioners based on simple majority voting, and can have three outcomes: approval, conditional approval, or prohibition.

Any decision of the EC can be annulled by the EU Courts. The merging parties can try a case before the Court of First Instance (CFI), while any member state may

⁴⁰ Two things should be noted on this issue. Firstly, a merger is considered to have a Community dimension if it meets certain thresholds in terms of turnover of the merging firms. As all the mergers considered here far surpass that level, the exact thresholds will not be discussed. Secondly, there are two provisions in the Merger Regulation concerning the jurisdictional issue. Under Article 9, known as the "German clause", a merger that concerns a limited market may be transferred to the relevant national competition authorities. Oppositely, the "Dutch clause" (Article 22) states that a merger may be transferred to the Commission on request of national competition authorities. For a general discussion of the relationship between the EC and Member State competition authorities, see chapter 10 in Cini and McGowan 1998.

appeal a decision to the Court of Justice (ECJ). In addition, third parties may bring an action to the CFI if they can show that they are directly and individually concerned.

Lastly, with reference to the discussion on professions in section 2.2.2., it should be noted that at the level of case handlers, the lawyer-to-economist ratio is higher in the MTF than in the US agencies.

3.3 Goals

Today, the most frequently stated goal of both US and EU competition policy is the protection of consumer welfare⁴¹. As explained in the previous chapter, market power does not only reduce allocative efficiency; it also transfers wealth from consumers to producers. There is no *economic* reason why consumer surplus should count more than producer surplus; rather, it is a *political* decision made by the US Congress and later the European Commission to prevent consumers from paying prices that exceed the competitive level (Bork 1978; Lande 1989).

Other goals are, however, still occasionally mentioned. In the interviews undertaken by the author, high-level US antitrust officials stated that the objective of competition policy is “some measure of efficiency” with most weight on consumers but not completely ignoring producers, i.e., somewhat closer to the neo-liberal understanding of competition. This would mainly manifest itself in an efficiency defence, and will thus be discussed further below.

In the EU, a main goal of competition policy has traditionally been the promotion of the internal market by breaking down privately constructed barriers to cross-border economic activity (Fox 1997; Cini and McGowan 1998; Bishop and Walker 1999). In the face of DG Competition respondents denying that this goal exists today, it is interesting to note that DG Enterprise continues to list the achievement of a genuine internal market as a rationale for competition policy (EC 2002a:84). The implementation of this objective does not necessarily conflict with consumer welfare

⁴¹ Consider, for example, the statements of the European Commissioner for Competition, Mario Monti (2001): “the goal of competition policy (...) is to protect consumer welfare by maintaining a high degree of competition in the common market. Competition should lead to lower prices, a wider choice of goods, and technological innovation, all in the interest of the consumer”; the EC Director-General for Competition, Philip Lowe (2002): “The protection of consumer welfare is naturally central to the Commission’s analysis of mergers”; the FTC chairman, Timothy Muris (2001): “there is widespread agreement that the purpose of antitrust is to protect consumers”; and the former US AAG, Charles James (2002): “the ultimate goal of antitrust must be consumer welfare”.

concerns, but there may be situations in which it does. Furthermore, the EU has frequently been accused of protecting not only competition, but also competitors (see, e.g., Monti 2001; Kolasky 2002), a notion strongly rejected by DG Competition respondents in Brussels. It is difficult to assess the validity of the claim at the present time; indeed, that is the task for the case studies to decide.

3.4 Substantive Tests

The US substantive test is formulated in Section 7 of the Clayton Act, which states that mergers shall be prohibited if their effect “may be substantially to lessen competition, or tend to create a monopoly”. In line with a goal of consumer welfare, this is interpreted in the US Merger Guidelines to mean that “mergers should not be permitted to create or enhance market power or to facilitate its exercise” (DoJ/FTC 1992/7:Section 0.1). The substantial test used by the EC is based on whether a merger “creates or strengthens a dominant position” (EU Council 1989:Art. 2). As such, the latter definition does not capture the essence of neo-liberal competition, as an increase in dominant position is not equivalent to efficiency losses and reduction in consumer welfare. In practice, however, it is a matter of debate how different it is from the US standard (see, e.g., EC 2001b:38-40; Kolasky 2001). The ECJ has defined dominance as “a position of economic strength [that gives the undertaking] the power to behave to an appreciable extent independently of its competitors, customers and ultimately of consumers”⁴². This resembles the definition of market power to a remarkable degree. Hence, one could argue that despite the difference in language, the dominance standard is coherent with the US substantial lessening of competition criteria *as long as it is applied out of concern for consumer interest*. If the assertion is correct that the EC protects competitors, not competition, it could easily be used for that purpose too.

3.5 Procedures

Before the substantial tests can be applied to a case, the competition authorities go through a series of steps in their merger analyses. The US has provided the logical structure for the evaluation in its Merger Guidelines, which will thus form the basis for

⁴² *Hoffmann-LaRoche & Co. AG v. Commission*, Case No. 85/76 [1979] ECR 461, para 38.

the discussion below, although the same actions are undertaken in EU analyses. The first part of the Boeing/McDonnell Douglas and the GE/Honeywell case studies (Chapters 5 and 6, respectively) will also be analysed following these procedures.

The first step is to define the relevant market and get a rough indication of the degree of concentration. The next three steps are equivalent to the first three of the five “liberal” factors outlined in the last chapter: the potential adverse competitive effects of mergers; entry conditions; and efficiencies. There are no explicit rules on *ex ante/ex post* regulation and time perspective (with an exception for entry conditions), although no analysis can be made without at least an implicit position in mind. Further empirical discussion must therefore wait to Chapters 5 and 6. To complete the discussion of formal procedures, a short section will be added on the so-called “failing firm” defence. In addition, the competition agencies also consider whether remedies undertaken by the merging parties can mitigate any anticompetitive effects, thus forming the basis for a conditional approval. This option will be discussed briefly.

3.5.1 Market Definition and Concentration

The definition of the relevant product and geographic markets is very similar in the US and the EU. The central point in both jurisdictions is that the market should include all products and/or services which consumers regard as substitutes sold in an area within which consumers can reasonably turn for an alternative source of supply⁴³ (DoJ/FTC 1992/7:Section 1.0; EC 1997b:Section 2).

The competition authorities also generally agree that market actors comprise companies that currently produce or sell the product in the geographic area, as defined above, as well as “uncommitted entrants”, i.e., firms that can enter or exit the market rapidly without incurring significant sunk costs. The approaches differ, however, when measuring concentration. While the US agencies use the HHI index, the EC considers the size of the market shares directly. It is important to note that the competition

⁴³ More formally, both the US and the EU have adopted a test based on the likely demand response of consumers to an anticompetitive price increase. A relevant market is thus defined as “a product or group of products and a geographic area in which it is produced or sold such that a hypothetical profit-maximizing firm (...) that was the only present and future producer or seller of those products in that area likely would impose at least a ‘small but significant and nontransitory’ increase in price, assuming the terms of sale of all other products are held constant. A relevant market is a group of products and a geographic area that is no bigger than necessary to satisfy this test.” (DOJ/FTC 1992/7: section 1.0). When performing this test, a ‘small but significant and nontransitory’ price increase is normally set to five to ten per cent.

authorities only use market shares as *indications* of possible competitive problems warranting further investigations.

The US uses the following number values for describing the degree of concentration in a market (DoJ/FTC 1992/7:Section 1.5): Post-merger HHI below 1000 indicates an unconcentrated market and no further analysis is required; post-merger HHI of 1000 to 1800 as well as an increase in HHI by more than 100 points may indicate anti-competitive effects and should be investigated further; post-merger HHI above 1800 and an increase of more than 50 points raise significant competitive concerns, while an increase of more than 100 points is “likely to create or enhance market power or facilitate its exercise”.

The EC Merger Regulation does not contain any formal thresholds for establishing potential market dominance, although past decisions have shown that market shares of less than 25 per cent are considered unlikely to cause competitive problems; that a 40 per cent market share, in the presence of significant barriers to entry, can constitute dominance; and that firms with market shares of 50 to 60 per cent or more are presumed to have dominance (Fox 1997:344; Morgan 2001:460).

3.5.2 The Potential Anti-competitive Effects of Mergers

Both competition authorities recognise that *horizontal mergers* can have adverse effects on competition in two ways: by awarding the merged firm market power so that it can act independently of its competitors and increase prices unilaterally; and by reducing the number of market participants, making it easier for firms to coordinate actions that could harm consumers⁴⁴. The US leans more towards using the second theory of harm out of fear that “[e]fforts to regulate the conduct of individual firms (...) run the risk of destroying competition in the name of saving it” (Kolasky 2002:9). The EC, on the other hand, has traditionally been concerned with single firm dominance as the Merger Regulation does not contain any provisions that explicitly deal with coordinated interaction. Over time, however, the EC, supported by a series of Court rulings, has gone further in investigating this kind of cases.

⁴⁴ Such behaviour also includes tacit or explicit collusion, which may be illegal itself and prosecuted under the other provisions of the US and EU competition laws.

Vertical mergers are considered by the US competition authorities to pose fewer anticompetitive concerns than horizontal ones and relatively few cases have been challenged over the last decade. When cases are in fact investigated, it is normally out of concern that an already dominant firm may use the control of an adjacent market to solidify the original dominant position (Pittman 2001). In the 1984 Non-horizontal Merger Guidelines (DoJ/FTC 1984), for vertical mergers to create anticompetitive barriers to entry, three conditions are listed as necessary (but not sufficient): need for two-level entry; increased difficulty of simultaneous entry of both markets following from the merger (e.g., due to higher capital requirements); and a structure and other characteristics of the markets conducive to anticompetitive performance. US case law shows that serious scrutiny starts only when each firm accounts for 20-30 per cent or more of the market (Fox 1997:348). Although the EC does not have specific guidelines for vertical mergers, it is generally recognised that it has taken a more aggressive stance on foreclosure (ibid.).

Conglomerate mergers only raise concern in the US if they are believed to harm potential competition (DoJ/FTC 1984:Section 4.1). Case law makes the application of the theory of harm very limited, while it is more used by the EC. The main divergence on conglomerate cases is, however, on the treatment of portfolio effects. Although both acknowledge that there is a theoretical case for challenging a merger on these grounds, they fiercely disagree on the practical relevance. The EC is generally positive to the possibility that a firm with pre-merger market power that expands its product range through a merger may leverage this market power into new products through tying or bundling. This ability increases, according to the EC, if the merger also results in an accumulation of financial strength (EC 2002b:239). Moreover, although it recognises that post-merger prices may decrease and produce welfare gains in the short term⁴⁵, the EC claims that in the longer term, welfare may decrease as competitors are foreclosed or eliminated, giving the merged firm the ability to raise prices (ibid.:242). Indeed, the Commission has challenged mergers on this basis and

⁴⁵ To quote the EC, this may happen as “a decrease in the price of one of the complementary products may increase the demand for the other complements in the range” (EC 2002b:242), which sounds a lot like the Cournot effect described in the previous chapter.

required divestitures to approve them⁴⁶. In the US, on the other hand, portfolio effects are not considered a legitimate reason for challenging mergers as “there is no basis for presuming that the efficiency advantages a firm may gain from acquiring the producer of a complementary product will lead to market power detrimental to consumer welfare in the foreseeable future, and only under very limited conditions is this even a hypothetical possibility” (DoJ 2002:219).

3.5.3 Entry Conditions

There is substantially more agreement between the US and EU on how to assess entry conditions. In both jurisdictions, the existence of barriers to entry is a necessary condition for finding a merger anticompetitive. The possibility of new entry as a mitigating factor to market power is analysed along the lines of timeliness, likelihood and sufficiency (DoJ/FTC 1992/7:Section 3.2-3.4; Neven et al. 1993:112). For entry to be timely it must normally be achieved within two years (although this may vary according to industry characteristics) from initial planning to significant market impact; an entry alternative is likely if it would be profitable at pre-merger prices, and if the entrant could secure such prices; and entry is sufficient if it happens on a scale large enough to deter anti-competitive practices. What constitutes an entry barrier is determined on a case-by-case basis, however. Thus, a more precise assessment of the US and EU approaches must wait until Chapters 5 and 6.

3.5.4 Efficiency Gains

The 1997 revision of the 1992 US Merger Guidelines explicitly recognised that mergers usually generate efficiency gains and that these gains may counterweight any negative effects the mergers may have on consumers. They do, however, require that the efficiencies be merger specific (i.e., would not be accomplished in the absence of the merger) and that the gains be transferred to the consumers. Moreover, it is the responsibility of the merging parties to substantiate any efficiency claim. The agencies conclude by stating that “efficiencies are most likely to make a difference in merger analysis when the likely adverse competitive effects, absent the efficiencies, are not

⁴⁶ See, e.g., *Coca-Cola/Carlsberg* (Case IV/M.833 (1998) OJ L145/41) and *Guinness/Grand Metropolitan* (Case IV/M.938 (1988) OJ L288/24).

great. Efficiencies almost never justify a merger to monopoly or near-monopoly” (DoJ/FTC 1992/7:Section 5). Two qualifications should be made. Firstly, this view is not confirmed by the Supreme Court. The last time the Court had the opportunity to review the issue (in 1967) it concluded that “possible economies cannot be used as a defense to illegality”⁴⁷. Although it is likely that it would not uphold this view today, it is currently precedent. Moreover, in the interviews with officials at the DoJ, it was claimed that gains accruing to producers might also be taken into account, although to a lesser extent than gains transferred to consumers. The exact weight given to each is not clear as the agency is “waiting for” a case where it can be explored in practice.

It has been debated whether the EC Merger Regulation allows for an efficiency defence, or if efficiency gains are ignored or even used as an argument *against* a merger (see, e.g., Neven et al. 1993 and Fox 1997). The MR itself (Article 2(1)(b)) is only of limited help, as it states that the Commission shall take into account “the development of technical and economic progress provided that it is to consumers’ advantage and does not form an obstacle to competition”. As is the case with the EC dominance test, it can be argued that it could contain an efficiency defence if that is how the EC chooses to interpret it. The DG Competition has admitted that “the precise scope for taking such considerations into account may not have been fully developed” (EC 2001b:40), but has vigorously denied that its approach amounts to an efficiency *offence* (see, e.g., Monti 2001). It is expected that one of the outcomes of the currently ongoing revision of the Merger Guidelines is that the EC will adopt a narrow efficiency defence requiring that the gains be substantial, timely, and verifiable, and to the benefit of consumers (EC 2002c).

3.5.5 Failing Firm

Both US and EU competition provisions allow a merger to be approved if either party to the transaction would be likely to exit the market absent the merger. The requirements for this “failing firm” argument to be used are very strict and have not been met in many cases (DoJ/FTC 1992/7: section 6; Kolasky and Venit 2000:82n3).

⁴⁷ *FTC v. Procter & Gamble Co.*, 386 U.S. 568, 580 (1967).

3.5.6 Remedies

Even if a merger raises competitive concerns, it is far more common that it is allowed to go ahead on certain conditions than that it is prohibited altogether. Technically, remedies could be either behavioural or structural. Both the US and the EU competition authorities have a strong preference for the latter, i.e., the divestiture of some unit(s) that will either emerge as a new competitive entity or strengthen an existing competitor. Moreover, experience has shown that the divestiture of an entire ongoing business and related assets tends to be the easiest to administer, the simplest to understand and the most effective (FTC 1999, 2002; EC 2001a; Muris 2001).

3.6 Cooperation between the Competition Authorities

In 1991, the US and EU competition authorities entered a bilateral cooperation agreement⁴⁸. The main elements include: *notification* of cases handled by one party, when these cases concern important interests of the other Party (Art. II); *exchange of non-confidential information* (Art. III); *coordination of the actions* of the competition authorities (Art. IV); *positive comity* (Art. V)⁴⁹; *traditional comity*, meaning that a Party should take into account the interests of the other Party (Art. VI); and prompt *consultations* at the appropriate level if requested by one of the Parties (Art. VII). Cooperation shall only take place, however, within the limits set by the national competition laws. (Agreement on competition laws 1991)

In addition, the merging parties can grant waivers of confidentiality, allowing the authorities to share and discuss confidential information that has been submitted to at least one of them (Parisi 1999). This has greatly facilitated the cooperation between the authorities on specific cases. The interviews in both Brussels and Washington, D.C., revealed, however, that neither authority had ever changed its mind about an outcome due to case-specific cooperation; the main advantage is perceived to be the exchanges of ideas, the sharpening of analysis as well as “noise reduction” in cases

⁴⁸ The EU did not formally approve the agreement until 1995 because the Commission, in signing the agreement itself, had gone beyond the scope of its competence. This did, however, “not prevent the agreement from being implemented, on an informal basis” (Cini and McGowan 1998:202).

⁴⁹ Positive comity means that a Party can ask the other Party to initiate appropriate enforcement activities if it believes that anticompetitive activities are carried out on the territory of the other Party. This section was hardly used under the 1991 Agreement. A new agreement on positive comity was concluded in 1998, leaving out, however, mergers (Agreement on Positive Comity 1998). This dimension of cooperation will, therefore, be excluded from the thesis.

where the authorities may disagree. There has recently also been established a working group to facilitate cooperation and discussion on more overarching issues, including theoretical and procedural questions.

3.7 Points of Access for Pressure-groups

As presented above, both the US and EU competition regimes seem to contain a substantial degree of formal autonomy for the competition agencies as decision-makers. This does not mean, however, that the technocrats are the only ones who can set premises for decisions. In this section, the potential for external pressure groups to influence outcomes will be examined. This will be done by identifying institutional and procedural points through which the groups are given access to the decision-making process. Once access is obtained, preferences other than liberal ones may be advanced. Focus will be on top officials in the competition agencies, politicians, and state agents, and their preferences will be assumed to reflect neo-mercantilist concerns, in line with the discussion undertaken in section 2.2.3.

In the US, there are a number of statutory and judge-made exemptions and immunities that limit the operation of the antitrust laws in certain situations or with regard to particular industries⁵⁰. This is interesting as it signals that there are issues that are seen as “too important” for or outside the scope of competition policy. In addition, some industries are regulated by other agencies than the DoJ/FTC⁵¹. These exemptions will not be discussed further, however, as the concern of this thesis is with understanding outcomes of merger cases that *are* subject to antitrust scrutiny. The

⁵⁰ In the merger context, the most interesting provision is the 1988 Exon-Florio Act, which authorizes the President to prohibit, without judicial review, mergers, acquisitions, or takeovers of US firms by foreign interests when such actions are deemed injurious to the national security of the US. ‘National security’ is, moreover, not defined; hence, the potential application of the provision is broad. In recent years, the focus of attention has grown well beyond the traditional defence sector to include, for example, companies with telecoms, computer, aviation and Internet related assets (Cheston et al. 2002). Still, of about 2000 notifications since 1988, less than two per cent have been investigated in detail, and only one deal has been blocked: In 1990, then-President George Bush ordered CATIC, a company owned by China’s Ministry of Aerospace Industry, to divest its interest in MAMCO, a US manufacturer of civilian airplane parts (Fox and Pitofsky 1997). This may slightly understate the impact of Exon-Florio, as several transactions have been modified or withdrawn prior to final decisions, but it has nevertheless played a limited role so far. In addition, industry-specific exemptions from federal antitrust laws are granted (fully or partly) to, *inter alia*, insurance companies, agriculture, newspapers, and professional baseball (!). It should be noted that defence industries are *not* on the list of exemptions.

⁵¹ Railroad mergers are reviewed by the Surface Transportation Board (STB) which has, according to DoJ respondents, taken a lax approach to industry consolidation. One DoJ interviewee did indeed see the STB as victim of regulatory capture. The Federal Communication Commission has joint competence with the competition agencies over telecom mergers. It applies a somewhat broader public interest standard when assessing a case, which has, according to DoJ respondents, occasionally led to disputes with the DoJ or the FTC.

following discussion on access points will be organised around the following actors: the leadership of the DoJ and the FTC; the President; federal departments and agencies; and the Congress.

It is not unreasonable to expect that, to the extent that they are at all receptive to political influence, the DoJ leaders, as part of the executive branch, would be more responsive to concerns voiced by the President and other members of government, while the FTC would be more sympathetic to the views of the Congress. Although the Commissioners are appointed by the President, they are elected for long periods of time, and the budgetary and supervisory dependence on the Senate may play a greater role. This understanding was substantiated by respondents both from the two competition agencies and the Senate. Moreover, in a historical study of antitrust policy-making from 1969 to 1976, Kovacic (1987) observed that the FTC pursued competition policy programmes that were consistent with, and receptive to, the policy preferences of the oversight committees in Congress (see below). The chances that FTC Commissioners may respond to political influence could be greater as not all have competency on antitrust issues. Those with backgrounds from different fields could be more sympathetic to special or broader public interests, although, to the knowledge of the author, there exists no evidence to substantiate this speculation.

The President appoints all federal chairpersons and commissioners, both for the competition authorities and for other departments and agencies. This provides a unique possibility to shape the general direction of policy. Fox, a prominent US antitrust scholar, claims that the greatest political influence on competition policy does indeed come from the philosophy current in the administration (Fox 1997). It follows that a change in government can lead to a new approach not only to antitrust, but also to industrial policy.

The Department of Defence plays a crucial role in mergers involving military product markets, for at least three reasons: It has substantial industry knowledge; it is frequently the largest, and often single, customer of the merging firms; and it is responsible for national security. In 1994, a Defense Science Board Task Force proposed various institutional reforms to improve DoD's involvement in the antitrust process, which were later adopted. Most importantly, it laid down the principle that the

DoD should provide relevant information to the competition agencies, but that the latter should decide alone whether to approve a merger or not (Defense Science Board 1994). Just as importantly, the DoD has, according to DoJ and FTC respondents, largely bought into the idea of competition policy in most cases, although there are still instances where they argue in favour of a merger despite its anti-competitive effects⁵². In such cases, it is highly unlikely that the competition agencies will go to court to block a merger, although it has happened⁵³.

An interesting situation arose at the end of the Cold War, when Congress made significant cuts in the defence budgets. As a result, the DoD saw a need for substantial industry restructuring and consolidation (DoD 1996). One element in this was a lax antitrust policy and after 1994, a series of mergers were undertaken⁵⁴. Despite the formal powers of the DoJ and the FTC, Kovacic (1999:469) claims that “DOD’s preferences concerning proposed mergers became decisive in determining whether the antitrust agencies would challenge specific defense industry transactions. The DOJ and the FTC would not insist on remedies that lacked DOD’s support. In practice, DOD – not DOJ or the FTC – became the crucial participant in the antitrust review process.”

One further complicating factor is the substantial disagreement *within* the DoD as to how much attention should be paid to antitrust concerns. This was exemplified in the 1998 Lockheed Martin/Northrop Grumman case⁵⁵. DoD officials at the highest levels of the individual armed services strongly encouraged the merger, but in the end, the political leaders of the Department joined the DoJ to oppose it (Kovacic 1999).

Promoting American competitiveness is part of the job description of the Department of Commerce and the International Trade Commission, and as such, it should come as no surprise that they attempt to influence the competition agencies in cases that are deemed important to US commercial interests. This is done both by

⁵² As one DoJ respondent said, not without irony, the DoD seems to have a strong belief in its ability to get a good price from a monopolist.

⁵³ E.g., in the Alliant/Olin merger (*FTC v. Alliant Techsystems*, 808 F. (DDC 1992)), the FTC went to the district court to prohibit it, while the DoD testified before the judge that it preferred approval.

⁵⁴ Between 1994 and 1997 there were more than 30 large defence mergers involving at least one US firm. As a consequence, the number of large contractors supplying two-thirds of military procurement fell from 13 in 1993 to a mere five in 1997 (Nelson and Stoner 1999).

⁵⁵ *U.S. v Lockheed Martin Corp.*, Case No. 4332 (DDC 1998).

contacting the relevant agency directly and by voicing concerns publicly (DoJ/FTC interviews).

The Congress in general and the Senate in particular has several means to influence the competition agencies. As discussed above, this applies more to the FTC than the DoJ. The former is dependent on the Senate to approve its budget annually, and the Subcommittee on Antitrust, Competition Policy, and Consumer Rights has the main responsibility for overseeing its activities (as well as those of the DoJ). The Subcommittee is considered to have, according to interviewees at the FTC and the Senate, the most to say on general policy issues, although it also holds hearings on a few merger cases each year that are of special concern. The Subcommittee takes a broader public interest approach than the DoJ and the FTC, but it is still promoting antitrust values to a greater extent than the rest of the Senate, and there is generally bipartisan agreement on its course of action.

Other Senate and House committees, like the one on Commerce, Science and Transportation, are more directly concerned with promoting goals like US competitiveness. They use all possible channels to influence merger decisions, both by attacking the competition authorities directly through, e.g., lobbying, and indirectly by arguing for an override of antitrust regulation. Liebler and Lash (1993) have shown, for example, that most Exon-Florio investigations are accompanied by congressional hearings and pressure to block a merger. In addition, there is an ongoing battle between the competition agencies, occasionally aided by the Subcommittee on antitrust, on the one hand, and other members of Congress, on the other, over which industries should be exempted from antitrust laws altogether. For the time being, the former group has enough to do just to maintain *status quo* (DoJ, FTC, and Senate interviews).

In the EU, there are no *per se* exemptions from the Merger Regulation. Article 21(3), however, allows Member States to protect their “legitimate” interests, which are defined to be public security, plurality of the media and prudential rules, and with the Commission’s agreement, other interests. None of these are defined any further and are open to interpretation. The DG Competition has, however, taken a strict approach to when this article can be applied, and is conscious of the fact that it may be used as a

protectionist device (Morgan 2001). E.g., the Commission interrupted an attempt by the Portuguese government to block a bid by Spanish BSCH for the Champalimaud financial group of Portugal, arguing that it did not satisfy the requirements of 21(3)⁵⁶.

There are, on the other hand, several indirect ways in which neo-mercantilist preferences can enter EU merger regulation. The discussion below will explore how Member States and other Directorate-Generals may influence decisions. Their chances to succeed are enhanced by DG Competition's strong preference for reaching consensus, both within the College of Commissioners and with the Member States.

Member States can influence the Commission through three different channels: direct pressure; their member(s) in the Advisory Committee; and the Commissioner(s) appointed from their country. Politicians like a president or prime minister, members of government, and parliamentarians who have a vested interest in a particular case but no formal way to influence the Commission, may make direct contact with DG Competition officials.

Another and probably more effective way to influence DG Competition is through the Advisory Committee. The Committee is very active and frequently takes part in oral hearings. Moreover, it commonly publishes its opinion, which, together with DG Commission's strong wish for consensus, can work to further increase the influence of the Committee.

Lastly, a Member State may attempt to influence an outcome through the Commissioner(s) that are appointed from its country. As mentioned earlier, the Commission as a whole makes Phase II decisions, and each Commissioner has one vote. One cannot ignore the possibility that the Commissioner may use this to promote the "national interests" of the country from which he or she is appointed⁵⁷. Examples include the proposed takeover in 1993 of the Canadian turboprop aircraft manufacturer, de Havilland, by ATR, a Franco-Italian joint venture consortium led by

⁵⁶ *BSCH/Champalimaud*, Case IV/M.1680, withdrawn 27.04.2000.

⁵⁷ Article 213 of the Treaty on European Union/Treaty of Amsterdam (1997) states that the Commissioners shall be "completely independent in the performance of their duties", that they "shall neither seek nor take instructions from any government or any other body", and that "[e]ach member state undertakes to represent this principle and not to seek to influence the members of the Commission in the performance of their tasks". These principles do not, however, always hold up in practice, as the examples of this section shows. See also, e.g., Laudati 1996 and Cini and McGowan 1998, 1999.

Aerospatiale (France) and Alenia (Italy)⁵⁸. Politicians from both countries favoured the transaction, which would have created a global competitor in the market and created R&D synergies and scale economies. Hence, the governments put pressure on “their” Commissioners to get the deal through, but lost nine to seven in the final vote.

There is close contact between DG Competition and other Directorate Generals during a merger investigation. This can take the form of both cooperation and conflict, as DG Competition is dependent on the substantial knowledge other DGs have on the market structures and industry features on the one hand, and the fact that other DGs have different goals on the other. Each of the prospects will be investigated below.

A merger investigation is information intensive. Depending on the background of the officials who work on a specific team, MTF may or may not have competence on the industry in question itself. Other DGs often compile a lot of high-quality information for their own activities, on which DG Competition can draw in a certain case. Moreover, other DGs may provide help with economic analyses of the industries concerned, e.g., with respect to how markets should be defined, entry conditions, and what remedies are appropriate to restore competition for a merger with some anti-competitive features to be approved (Commission 2002A:90; Brussels interviews). Hence, there are both formal and informal inter-service consultations between DG Competition and other DGs. There is also, however, a significant potential for conflict, stemming both from different priorities and from firms who may find it easier to gain support from other DGs than from Competition.

DG Enterprise (former Industry) has as its objective to help the EU “to become the most competitive and dynamic knowledge-based economy in the world, capable of sustained economic growth with more and better jobs and greater social cohesion” (EC 2000:2). This will again facilitate the overarching goal of completion of the internal market (EC 2002a). Historically, this goal has been achieved largely by an active industrial policy, as defined in the section on neo-mercantilism, and affection for European champions (Sauter 1997). Since the 1990s, DG Enterprise has taken a different approach to industrial policy, and sees vigorous intra-EU competition as a key to competitiveness both internally and externally. This has obviously lessened the

⁵⁸ *Aerospatiale/Alenia/deHavilland*, Case IV/M.53 (1991), OJ C128.

potential for conflict between the two DGs, and from a general economic perspective, “there exists no *a priori* reason for conflict between competition and enterprise policy” (EC 2002a:85). Still, it is obvious that there may be cases where the interests of the two policy areas may diverge. In its “European Competitiveness Report 2002”, DG Enterprise describes one particular situation: “Striking the right balance between the competition and competitiveness goals is a particularly challenging task for antitrust analysis, as many practices may restrict competition to some degree but also create efficiencies” (ibid.:91). Another issue concerns the “need to foster innovation by creating widespread and closely intertwined knowledge pools”, which DG Enterprise openly admits may imply anti-competitive behaviour (ibid.:85). Moreover, DG Enterprise may encourage a restructuring or consolidation of an industry, and a series of mergers can be an effective tool to achieve that goal. This may or may not have anti-competitive effects. Of specific cases, the 1992 *DuPont/ICI* merger⁵⁹ and the aforementioned *Aerospatiale/Alenia/de Havilland* case can serve as high-profile examples of conflicting views between the two.

In addition to the inter-DG contact during the investigation of a case, the potential for non-competitive concerns to infuse the decisions of the DG Competition arises from the fact that it is the College of Commissioners that make the final decisions in Phase II. According to EC respondents, the DG Competition’s search for consensus may cause it to adjust its arguments and draft decisions to avoid majority voting. This procedure, and the possibility that Commissioners may be concerned with both their nationality and their own DG rather than the competition issue at stake, has lead Wolfgang Kartte, a former head of the German *Bundeskartellamt* (Federal Cartel Office), to conclude that “politicisation has been built into EU merger control” (quoted in Cini and McGowan 1999:190).

One last issue stemming from the Phase II procedure should be mentioned. Remedies are often introduced at the very end of the merger investigation. This implies that the economic soundness of the remedies may not be properly evaluated by the MTF, but are voted on by the Commissioners based on a perceived effect on competition. It is difficult to assess how serious this problem actually is, but it should

⁵⁹ *Dupont/ICI*, Case IV/M.984 (1997), OJ C275.

be clear that Commissioners arguing in favour of approving a deal will use apparently substantial last-minute concessions for what it is worth to force a deal through. The problems arising from the late deadlines were also confirmed in the discussions with DG Competition officials.

A last factor that has raised criticism against the EU competition regime is the Commission's role as "investigator, prosecutor, judge, and jury" (Kolasky 2001). Although all decisions could be subject to judicial review, the process typically takes several years and by the time the Courts reach a decision, it is often too late for the merging parties to resurrect the deal. Thus, once an outcome has been set, it is very difficult to change it.

3.8 Conclusion

In this chapter, the US and EU competition regimes have been discussed on a formal level. It is evident that the competition agencies in both jurisdictions have the legal right to make decisions in merger cases and that they are given, in the build-up of the competition agencies, at least some autonomy. Furthermore, goals and procedures were discussed, indicating what version of liberalism would dominate if competition officials make the decisions. Both jurisdictions set consumer welfare as their single objective. Although this is a somewhat narrower standard than the maximisation of economic efficiency as it excludes producer surplus, it comes close to the neo-liberal version of economics. Indeed, it is generally accepted in antitrust law and economics and among neo-liberally minded politicians to set consumers at the centre.

In the US, both the substantive test and the procedures appear to be informed by and well suited to obtain such a goal. This also holds true for the interpretation of the theories of harm, the definition of entry barriers, and the approach to efficiencies. In the extension of the latter, it also seems likely that focus would be on efficiency-reducing barriers to entry. As an efficiency defence may encompass some concern for producers, it signals a small deviation from a pure consumer surplus standard in the direction of the neo-liberal total welfare model discussed in Chapter 2. There is little evidence that the US regime carries any Ordo-liberal ideas, however.

The EU regulation is somewhat more ambiguous: The dominance standard, the unclear approach to efficiency gains, and thus to barriers to entry, and the more activist policy against foreclosure effects from vertical and conglomerate mergers all appear to have more in common with Ordo- than neo-liberal ideas. There has been a development over time, however, in the direction of neo-liberalism. It is thus possible that the official standards have not been changed yet, but are interpreted in new ways. On the other hand, as discussed in section 2.2.2, ideas tend to be sticky. Hence, it could be the case that while the goal has been changed at the highest level, it has not penetrated through to lower-level case handlers. This must be for the case studies to examine. For now, it will suffice to say that the EC merger regime has a greater propensity for making decisions based on an Ordo-liberal rationale than what is the case in the US.

Despite substantial formal autonomy, the design of the competition institutions and the official procedures contain several points through which politicians and state agents can access the decision-making processes in both the US and the EU. It must eventually be a matter of empirical investigation to conclude on what ideas or interests prevail in actual cases.

Chapter 4. Hypotheses

In Chapter 2, different explanations for why a particular outcome is reached were proposed. To the extent that competition policy is autonomous from political and societal interference, technocrats are perceived as the main premise-setters, and outcomes will reflect some version of liberalism. If, on the other hand, pressure-groups influence decision-making, outcomes will reflect the interests of these groups. The international dimension of the mergers examined in this thesis led to a focus on politicians and state agents as the main actors, promoting national security, wealth, and competitiveness (what was called neo-mercantilism). These explanations are designed for the investigation of single outcomes, as discussed in section 2.1.1. The hypotheses should, however, reflect the comparative dimension of the research question presented in Chapter 1, i.e., why outcomes vary between jurisdictions. Thus, the three explanations of single outcomes will be reduced to two competing hypotheses about why outcomes *differ*. The first takes as its starting point that competition policy is autonomous:

H₁: Outcomes differ between jurisdictions because the technocrats in each act based on different versions of liberalism

Although the causal complexity of the explanations makes it difficult to produce strong predictions, some expectations about the direction of this hypothesis can be made from the examination of the US and EU competition regimes undertaken in Chapter 3: While the US regulation appears to be in close accordance with neo-liberal ideas, it was concluded that the EU regime had a greater propensity for including Ordo-liberalism.

The second hypothesis is relevant if competition policy is *not* autonomous in at least one jurisdiction:

H₂: Outcomes differ between jurisdictions because one or both are based on concerns for national security, wealth, and competitiveness (i.e., neo-mercantilism), furthered by politicians and state agents, rather than on some version of liberalism

Hence, the second hypothesis supposes that a neo-mercantilist rationale underlies the outcome in at least one jurisdiction. The discussion in Chapter 3 showed that both the US and the EU competition regimes contain features that make H_2 plausible, an observation that is, *a priori*, equally true for both jurisdictions.

H_2 contains two alternative explanations for why outcomes diverge: Firstly, if competition policy is autonomous in the other jurisdiction, the outcome there will reflect either neo- or Ordo-liberal ideas; secondly, if politicians and state agents are the central premise-setting actors there too, the outcome will be based on neo-mercantilist interests. In the latter instance, the relative gains logic of neo-mercantilism assures that outcomes *will* differ, unless the merger produces the exact same costs and benefits in both jurisdictions. In the former case, there is a possibility that outcomes may not differ even if they are based on the assessment of different factors. That could also be true for H_1 . In this thesis, however, the problem does not exist by design as cases have been selected based on the condition that outcomes do indeed differ.

In the following two chapters, the Boeing/McDonnell Douglas merger and the attempted GE/Honeywell merger will be scrutinised in detail. The same framework will be applied in both cases, although allowing for the flexibility that is necessary to reflect the differences between them. The studies will, as drawn up in Section 2.2.6, have two main parts. In the first, the decisions as set out by the competition authorities will be analysed. This will be done by examining and comparing the US and EU stances on central aspects of the case, roughly following the procedures outlined in Section 3.5. Firstly, the pre-merger situation of the industries will be discussed with respect to market definitions, including the identification of market participants and degree of concentration, and the existing barriers to entry. Then, the evaluation of the effects from the (proposed) mergers will be analysed. This will be done by, on the one hand, considering possible theories of harm that point in direction of blocking the merger. On the other, factors that mitigate any harm will be considered, with weight on efficiency gains. Proposed remedies will also be assessed.

As discussed in Chapter 2, the relevant places to look for differences between the two jurisdictions if they are due to different versions of liberalism (as suggested by

H₁), are (1) whose interests are protected or promoted, (2) how entry barriers are defined, (3) how efficiency gains are assessed, (4) what time perspective is taken, and, (5) in the case of uncertainty, whether a merger is approved or not. Evidence of different stands on (1) can mainly be found in the assessment of the pre-merger competitive conditions and in the theories of harm; disagreement on (2) will show up in the pre-merger evaluation of entry barriers as well as in the theories of harm; (3) will be discussed under the heading of efficiency gains; (4) and (5) flow through the whole analyses and are displayed in how and what theories of harm and mitigating factors are assessed. While all factors will be relevant to explain the difference in outcome in the GE/Honeywell case, only some will prove to apply to the Boeing/McDonnell Douglas merger.

The second part of the case studies, which respond to H₂, will be concerned with the processes leading up to the outcomes and the circumstances surrounding the cases. The analyses will follow the three-step strategy presented in section 2.2.6: Firstly, is the merger a “likely case” for neo-mercantilism? Secondly, are there “flaws” or inconsistencies in the merger decisions from the perspective of any version of liberalism (i.e., an evaluation of the sufficiency of H₁)? Lastly, are there circumstances speaking in favour of or against the proposition that neo-mercantilist interests have influenced the outcomes? The latter discussion will be organised around the institutional and procedural points through which pressure-groups can gain access to the decision-making process that were identified in section 3.7.

Chapter 5. The Boeing/McDonnell Douglas Merger

On December 15, 1996, the Boeing Company (Boeing) and the McDonnell Douglas Corporation (MDD), two American aerospace producers, announced their intention to merge. The USD 13.3 billion merger would include the civil as well as the military divisions of the companies. The main markets concerned were those for large commercial aircraft and several defence products. Although the EC originally had objections to both parts of the case, in its final decision, the defence aspects were left out. The reason for this turnaround will be analysed in the section on neo-mercantilism. The main analysis will thus be of the civil part of the merger, which according to the EC raised both horizontal and conglomerate concerns. In addition, vertical agreements that Boeing and three US airlines had entered prior to the merger also became subject of discussion. On July 1, the Federal Trade Commission, which handled the case in the US, decided in a four-to-one vote that it would not challenge the merger. 30 days later, the EC finally let the merger pass, but only after BMDD had acceded to several concessions. In the meantime, the world had been brought to the brink of a trade war. What happened?

5.1 Pre-merger Situation: Market Definition and Entry Conditions

5.1.1 Market Definition, Firms, and Industry Concentration

The US and the EC competition authorities agreed on all aspects of the market definition. The market for “large commercial aircraft” was world-wide and consisted of only three competitors: Boeing, MDD, and Airbus. At the time of the merger, Boeing was the largest civil aerospace producer in the world and held a 64 per cent share in the large commercial aircraft market. By the steady development and introduction of new models it could offer its customers a whole “family” of aircraft. About 70 per cent of its revenues came from this line of business, while the remainder originated from its defence and space operations. Douglas Aircraft Company (DAC) was the division responsible for civil aircraft production at McDonnell Douglas, which accounted for around 30 per cent of the turnover (with the rest accruing from its military and space businesses). It had six per cent of the market, a share that had

decreased steadily over the last couple of decades, and a more limited product line. The only other firm, with a market share of about 30 per cent, was Airbus Industrie, a European consortium owned by Aérospatiale of France, Daimler-Benz Aerospace (Germany), British Aerospace (UK), and CASA (Spain). It was established in 1970 and could, at the time of the merger, offer a full product line with ten aircraft in all sizes, with the exception of a super-jumbo. Table 5.2 shows the market shares of the three competitors from 1975 to 1997.

Table 5.1. Shares of Sales of Large Commercial Aircraft (1975-1997)

| Company | 1975 | 1985 | 1990 | 1997 |
|---------|------|------|------|------|
| Airbus | 5 | 20 | 25 | 30 |
| Boeing | 65 | 60 | 60 | 64 |
| MDD | 25 | 20 | 15 | 6 |

Source: Kovacic 2001:85

5.1.2 Entry Conditions

New entrants would have to overcome very high barriers to enter the commercial aircraft market. Firstly, a firm would have to undertake huge up-front investments, in particular in R&D, before it could even start producing any aircraft⁶⁰. Much would be in the form of sunk costs, making uncommitted entry impossible. Secondly, the characteristics of the industry are such that there are large scale, scope and learning curve economies. Scale economies follow from the spread of fixed costs over more units; basic aircraft design can be shared across different models, giving rise to scope economies (moreover, the EC (1997a:para 41) asserted that these “commonality benefits, such as engineering, spares, inventory, and flight crew qualifications, are very influential in an airline's decision-making process for aircraft type selections and may frequently lead to the acquisition of a certain type of aircraft even if the price of competing products is lower”); while experience in coordinating the thousands of tasks the production of an aircraft involves, produces learning curve effects. In fact, the industry rule-of-thumb is that production costs decrease by 20 per cent when output doubles (Neven and Seabright 1995:322). Thirdly, government subsidies could also

⁶⁰ According to Boeing, initial development and investment costs for a new wide-body jet amounted in 1997 to over USD 10 billion (EC 1997a:para 49)

provide for a barrier to entry and both Airbus and Boeing have received substantial direct or indirect support over the years. It is telling that the last new successful entrant in the market was indeed Airbus in 1970. On the other hand, several firms had exited within the last 4 decades (see table 5.2).

Table 5.2. Producers of Large Commercial Aircraft (1955 and 1995)

| Producers in 1955 | Producers in 1995 |
|-------------------------------------|-------------------|
| Boeing | Airbus |
| De Havilland | Boeing |
| Douglas | McDonnell Douglas |
| General Dynamics (Convair Division) | |
| Lockheed | |
| Sud-Est Aviation | |
| Vickers | |

Source: Kovacic 2001:814

Lastly, at the time of the merger, Boeing had entered into three vertical 20 years exclusive supply agreements with American, Continental, and Delta Airlines. These accounted for between 11 and 13 per cent of the market⁶¹. The EC argued that the impact was magnified because the airlines were “launch customers”⁶² and that, due to the very long operating life of an aircraft, their effect would extend beyond 20 years. As will be discussed below, the FTC did not share this understanding of the role of the vertical agreements. The competition authorities did agree, however, on the overall possibility for new entry: it would neither be timely, nor likely, nor sufficient.

5.1.3 Summary of the Pre-merger Situation

As shown by the statements below, on the face of it, the FTC and the EC agreed on the pre-merger situation in the industry. The US agency stated that

“the proposed merger appears to raise serious antitrust concerns. The transaction involves the acquisition by Boeing, a company that accounts for roughly 60% of the sales of large commercial aircraft, of a non-failing direct competitor in a market in which there is only one other significant rival, Airbus Industrie, and extremely high barriers to entry.” (FTC 1997)

⁶¹ Numbers according to the FTC and the EC, respectively. This difference did not, however, have any significant impact on the conclusions of the competition authorities. For that to happen, the size of the foreclosure would have had to be substantially higher (see below on the analysis of vertical agreements).

⁶² A “launch customer” is an airline or another aircraft purchaser (e.g., a leasing company) that has sufficient resources to commit itself to entirely new aircraft models or new families of aircraft.

The EC, on its side, concluded even more clearly:

“In view of the various characteristics of the current structure of the existing markets for large commercial jet aircraft, [...], in particular the existing markets shares of Boeing, the size of its fleet in service, the recent conclusion of long-term exclusive supply deals with major customers, and the lack of potential new entrants, the Commission has reached the conclusion that Boeing already enjoys a dominant position on the overall market for large commercial aircraft” (EC 1997a:para 52).

5.2 Effects from Merger: Theories of Harm and Mitigating Factors

5.2.1 Theories of Harm

From the EC point of view, any improvement in Boeing’s position following from the merger should be regarded as an anti-competitive increase in dominance. It found this to happen through: (1) “the addition of MDC’s competitive potential in large commercial aircraft to Boeing’s existing position in this market”; and (2) “the large increase in Boeing’s overall resources and in Boeing’s defence and space business which has a significant spill-over effect on Boeing’s position in large commercial aircraft and makes this position even less assailable” (EC 1997a:para 53). As will become evident, the FTC shared neither of these fears. In the following, each theory of harm will be discussed as will the potential for entering vertical agreements.

Horizontal Overlap

The EC argument for why the merger created a horizontal concern was straightforward. In an already concentrated market with only three players the merger would create a duopoly, with the combined Boeing/McDonnell Douglas (BMDD) having a share of sales of 70 per cent and Airbus 30 per cent. The Commission further explained how this would have a negative competitive impact. As one of three actors in a bid for new aircraft, MDD’s past competitive influence was seen as greater than indicated by its market share. This notion was later supported by Lexecon (1997), an independent consulting firm specialising in the economics of antitrust law⁶³. However, as it had received virtually no new contracts since 1996, the EC concluded that it was “no longer a real force in the market *on a stand-alone basis*” (EC 1997a:para 59, emphasis added). Together with Boeing, however, the EC considered that it could still

⁶³ In a bidding study, i.e., a comparison of prices paid when MDD did not bid and when it did bid for a contract, Lexecon showed that the overall price effect of MDD was 7.6 per cent. When controlling for size of the sale and other factors considered relevant, the effect was slightly smaller, but still significant (Lexecon 1997).

be a significant factor and help strengthening Boeing's market power. If the latter were to decide to continue the production of one or more MDD aircraft, it would give MDD credibility among customers and revive its position. If, on the other hand, Boeing were to decide to phase out MDD's production, it could use its preferential access to large existing customers to be the preferred supplier for new aircraft in the future at the cost of Airbus. In fact, MDD had a 24 per cent customer base measured in terms of the current fleet in service, and adding Boeing's 60 per cent, Airbus would be left with a mere 16 per cent (EC 1997a:paras 54-64).

Initially, the FTC considered the case to be as straightforward a prohibition as did the EC. Simple calculations show that post-merger HHI would be 5800 with an increase of 768 points, a level well above the threshold set in the US Guidelines for fearing that a merger is "likely to create market power or facilitate its exercise". According to FTC officials interviewed by the author, the case turned, however, on the assessment of the future of MDD. Argued the majority of four Commissioners:

"(1) McDonnell Douglas, looking into the future, no longer constitutes a meaningful competitive force in the commercial aircraft market and (2) there is no economically plausible strategy that McDonnell Douglas could follow, either as a stand-alone concern or as part of another concern, that would change that grim prospect." (FTC 1997)

The key difference to the EC assessment of the case was, thus, that the FTC did not consider MDD to be a meaningful competitive force, even as part of another firm. As clarified in later speeches by FTC officials (see Pitofsky 1997a), the argument was based on the so-called "General Dynamics" defence, named after a Supreme Court decision from 1974⁶⁴. The DoJ then challenged a merger between two coal producers based on their historic and current market shares, ignoring that the firms had no uncommitted coal reserves and were unable to acquire any. The Supreme Court ruled in favour of the firms, stating that Section 7 of the Clayton Act should be concerned with a merger's impact on future sales rather than with past performance, and without any available reserves, it would also not be able to compete for future contracts.

In the BMDD case, the FTC applied the same logic on DAC: If it were to be considered a competitive force, the relevant place to look was not the customer base nor the backlog, but rather its ability to compete for future sales. Based on interviews

⁶⁴ United States v. General Dynamics Corp., 415 U.S. 486 (1974).

with over 40 domestic and foreign airlines, the majority of Commissioners concluded that DAC was not a potent competitor:

“[T]he failure to improve the technology and efficiency of its commercial aircraft products has lead to a deterioration of Douglas Aircraft's product line to the point that the vast majority of airlines will no longer consider purchasing Douglas aircraft and that the company is no longer in a position to influence significantly the competitive dynamics of the commercial aircraft market” (FTC 1997).

FTC Commissioner Mary Azcuenaga dissented with the majority on DAC's possible impact. She argued that although “Douglas has a small share of the commercial aircraft market, (...) that does not mean that it exercises no competitive constraint. The evidence shows that Douglas has added an element of competition at the stage at which commercial aircraft producers bid for the business of airlines, and it has continued to win some business” (Azcuenaga 1997). Hence, she ruled for a prohibition of the merger. This argument was in essence the same as the one advanced by the EC.

Moreover, Azcuenaga suggested that DAC's unfavourable position could be the result of the firm's strategic moves to weaken its competitive capability and remove the horizontal overlap with Boeing in order to avoid a government challenge. Approving the merger, she claimed, would send out the wrong message to other firms, and create an incentive for them to behave similarly (ibid.). The other four Commissioners rejected this view as unsupported “speculation” (FTC 1997).

Conglomerate Effects

The second theory of harm proposed by the EC was based on an increase in Boeing's defence and space businesses, which it argued would have a significant spill-over effect on its position in the large commercial aircraft market and on Boeing's overall resources. The Commission never used the term “portfolio effects” or any equivalent ones to describe these features in its Final Decision, but has later referred to them as “range-related effects” (EC 1997b:56).

Firstly, with regards to greater financial strength and size, the Commission estimated that Boeing would double its government-funded military R&D portfolio and triple its revenues generated in the defence and space sector through the merger. This, it claimed, would “increase the scope of cross-subsidization of Boeing's sales in commercial aircraft cases where Boeing wants to meet specific competition” (ibid:para

78). The EC did not, however, argue that Boeing would use these greater financial resources to engage in predatory pricing, which would be illegal under both EU and US regulations. What it did claim was that it would increase Boeing's ability to cope with economic cycles. Lastly, the EC argued that post-merger, Boeing's greater size would increase its bargaining power vis-à-vis suppliers to the detriment of Airbus (ibid:paras 104-8).

Secondly, the EC asserted that the merger would increase Boeing's sales through offset deals and bundling (ibid:paras 109-12). Offset deals are agreements where a firm provides, e.g., technology in the purchasing country in exchange for that country purchasing the firm's product. The Commission predicted that by adding MDD's defence business, Boeing would increase sales of commercial aircraft to foreign state-owned airlines. Similarly, argued the EC, "the concentration would increase Boeing's ability to enter into 'bundling' deals in certain countries, combining the marketing of Boeing's commercial and [MDD's] military aircraft" (ibid:para 112). It offered, however, no further arguments or evidence of how bundling would take place or what the effects on consumers and competitors would be.

Lastly, the Commission claimed that there was at least a broad commonality between military and commercial aircraft production and that Boeing would benefit from the transfer of technology, know-how, and equipment developed in the defence sector to the civil division of the company (ibid:paras 83-97).

The FTC did not share the EC's worries for any of the conglomerate effects. Neither the majority nor the minority commented on these aspects in their statements, but from subsequent speeches (see, e.g., Pitofsky 1997b and Valentine 1997) as well as from the interviews undertaken by the author, it is clear that they were no source of concern for the FTC. Rather, "pricing flexibility" and the "ability to offer a wider range of product models with similar technologies" were regarded as efficiencies (Pitofsky 1997b). This will be discussed in greater detail in section 5.2.2.

Vertical Agreements

As discussed in the section on entry conditions, the vertical supply agreements between Boeing and three US airlines were entered into prior to the merger. There

were some discussions about the relevance of including them in the merger investigation at all, but the FTC did not voice any criticism on that point (Valentine 1997). As long as they were considered to have an impact on Boeing's competitive strength and ability to exercise market power, it appears fair that they were included in a case that, allegedly, would further reinforce its position. Moreover, the EC asserted that post-merger, Boeing's capacity to enter into such agreements would increase, "in particular with those airlines which currently operate both Boeing and [MDD] aircraft" as "Boeing could also offer the provision of additional [MDD] aircraft" (EC 1997a: para 68)⁶⁵. Hence, the EC considered a scenario where the three deals spurred the other top seven airlines to enter into similar agreements, thus foreclosing 40 per cent of the market, to be "quite feasible" (ibid:para 71).

The FTC majority did not find the agreements illegal under US antitrust laws, but agreed that they were "potentially troubling" and would, therefore, "monitor the potential anticompetitive effects of these, and any future, long term exclusive contracts" (FTC 1997). The impact was not severe enough, however, to require any immediate actions. Again, Commissioner Azcuenaga departed from the majority as she saw no reason to be concerned: A foreclosure of 11 per cent is well below any level US Courts would even begin to consider problematic (Azcuenaga 1997).

5.2.2 Mitigating Factors

Efficiency Gains

Even if a merger raises competitive concerns, it may be approved on the grounds that it creates efficiencies that outweigh an increase in market power. As discussed earlier, there are substantial scale, scope, and learning curve economies in the commercial aircraft industry. It has indeed been suggested that the commercial aircraft market only has capacity to support two producers of large airliners (Neven and Seabright 1995). Others, like Laura d'Andrea Tyson (1992:156), have gone even further and claimed that the attainment of static production efficiency can press the industry "toward a

⁶⁵ One could thus argue that the EC was concerned with portfolio rather than vertical effects. As the fundamental worry was unambiguously with foreclosure through buyer-seller integration and the FTC response was also based on this concern, the effects are, however, discussed within a vertical framework. Moreover, the label has no impact the analysis from the point of view of the EU and US legal systems.

natural monopoly with a single producer dominating the global market”. The EC did not consider efficiency gains of this kind. Rather, as discussed above, it pointed to commonality benefits across different models and platforms and spill-over effects from military to commercial aircraft production as anticompetitive. Although the FTC, as it did not find the merger to harm competition, made no explicit trade-off between negative and positive effects of the merger, it did point out that the factors singled out by the EC would have been considered pro-competitive. Also, the FTC seemed to support the notion that there was only room for two players in the industry by stating that “the merger did not reduce existing aircraft producers from three to two; rather, the market already consisted of only two significant players” (Valentine 1997).

Vertical agreements are, as discussed in Chapter 2, generally seen as efficiency-enhancing. This argument has been put forward in the BMDD case as well, on the grounds that the long-term contracts would reduce risk and facilitate planning and financing in an industry characterised by great uncertainty (Gifford and Sullivan 2000). They were, moreover, proposed by the airlines themselves, not Boeing, which may point in the same direction. Neither the EC nor the FTC majority seemed to consider these potential efficiency gains, however; rather, the agreements were a point of concern.

Failing Firm Defence

There was some discussion on whether the merger could fall under a so-called “failing firm” defence. The US and the EC competition authorities agreed, however, that although MDD had experienced a decrease in market share over the past two decades and had not signed many new contracts lately, it was not “failing”. It still had a large customer base and significant assets in the market, both McDonnell and DAC still showed profits, and the company was not likely to exit the market in the very near future (EC 1997a; FTC 1997).

Remedies

In order to approve the merger, the European Commission required a series of remedies to address the abovementioned concerns. A complicating factor was that, except for Boeing, there were no prospective buyers for DAC. Hence, the preferred

remedy – a divestiture of the whole civil part of MDD – was unattainable. Moreover, as discussed above, neither of the competition authorities considered it to be a viable business on a stand-alone basis. To find a solution, the EC settled for a Boeing proposal mixing structural and behavioural remedies.

Firstly, with regards to leveraging the position of DAC, Boeing agreed to maintain DAC as a separate legal entity for a period of ten years and provide to the EC a report describing its performance results. Boeing also committed to providing customer support for DAC aircraft at the same quality level provided for Boeing aircraft and not to withhold or threaten to withhold support for DAC aircraft because the operator proposes to purchase another producer's aircraft. Moreover, Boeing agreed to not use its privileged access to DAC customers to persuade them to purchase Boeing aircraft. Secondly, Boeing consented to cancel its supply agreements with American, Delta and Continental, and to not enter any new ones for a period of ten years. Thirdly, Boeing agreed to license any government-funded patent and related know-how to other aircraft manufacturers on a non-exclusive, reasonable royalty-bearing basis. Fourthly, the Commission would receive an annual report from Boeing regarding US government aeronautics R&D projects in which it participates, in order to increase transparency. Lastly, Boeing promised to not exert any improper influence on its suppliers, by increasing or decreasing supplies or subcontracted R&D activities. (EC 1997a:paras 114-9)

5.2.3 Summary: The FTC and EC Decisions in Light of the Five Liberal Factors

The analysis above shows that the “versions of liberalism”-hypothesis (H_1) can shed some light on why the EC and the FTC reached diverging decisions on the civil aspects of the BMDD merger, although the results are ambiguous. To sum up the main findings, the five liberal factors discussed throughout this thesis will be revisited. Firstly, *whose interests* did the competition agencies protect? The key point in the FTC majority argument was that Boeing would not gain market power from the merger; thus, consumers would not be harmed. How the deal would affect the position of Airbus *per se* was not discussed. The reason for this, according to FTC respondents, was that it was irrelevant as long as post-merger prices would not increase. The

European position is less clear. It is evident that the EC believed that Airbus would be hurt as a result of the merger and that this would affect consumers negatively. Whether the EC was concerned for the well-being of Airbus as such, however, cannot be read out of its decision. The interviews in Brussels also did nothing to clarify the case.

Secondly, how were *entry barriers* defined? The FTC and the EC agreed on most aspects of this issue. Disagreement occurred, however, on the evaluation of the foreclosure effects from the vertical supply agreements. The EC found them so problematic that it considered blocking the merger. Although the FTC majority position was vague, it was at least less negative; the dissenting commissioner found no reason to worry. The third factor, the assessment of *efficiency gains*, revealed clearer differences. As discussed in Section 5.2.2, the EC let commonality benefits across platforms and spill-over effects from military to commercial aircraft production count against the merger, i.e., an efficiency offence. Although the FTC approval rendered an efficiency defence unnecessary, the agency made it clear that it considered the two points that concerned the EC to be pro-competitive.

Fourthly, the distinction between *ex ante* and *ex post* regulation materialised once. Both the FTC majority and the EC stated that the vertical supply agreements were troubling. They took different positions, however, on how to deal with it: While the EC required their determination before approving the merger, the FTC would have been satisfied with monitoring their impact and act if they produced negative effects. The fifth factor, *time perspective*, was not relevant to the review.

5.3 The Case for Neo-mercantilism

There were additional factors surrounding the Boeing/McDonnell Douglas merger that need to be scrutinised before any conclusions can be drawn on what created the different outcomes. Applying the approach outlined in Chapter 2, the case for neo-mercantilism will be analysed below.

The first step is to discuss whether the properties of the merger made it a “likely case” for such influence. The BMDD case did indeed satisfy the requirements. Firstly, the merger between the two US companies would turn the market for large commercial aircraft into a duopoly. With a fairly constant market size, the deal would

produce a clear winner and loser: The strengthening of Boeing would be at the cost of Airbus⁶⁶. Moreover, Airbus was considered a true European champion, established to counter the American dominance on the aircraft manufacturing market, and had received substantial financial assistance through subsidies and other means (Neven and Seabright 1995). Boeing had, similarly, benefited from support from the US government (Lawrence 2001).

Secondly, the industries concerned were very sensitive. The structure of the market for large commercial aircraft, together with the spill-over effects from high-technology R&D activities has made this, literally, a textbook example for strategic trade policy. It has produced conflicts between the US and the EU in this industry since the very establishment of Airbus that have only been contained by two “peace agreements”: The first, written into the Tokyo round of the GATT treaty in 1979, forbade uneconomic pricing for airliners; the second, from 1992, limited the use of “launch aid”, i.e., government support to develop a new aircraft model (Economist 1997). The proposed BMDD merger brought the conflict back on the table, threatening to change the balance between the Airbus and Boeing – and hence, between Europe and America.

The other part of the merger, which has not been analysed above, concerned the most sensitive industry of all: defence. While not as relevant to the EU *per se*, given the national control with military programs, it was acute to the US government. As discussed in Chapter 3, the end of the Cold War had caused a need for a consolidation of the defence industry.

Thirdly, the failure of the merger could also have significant impact on employment. The US government made an argument to the EC under the traditional comity provision of the 1991 Cooperation Agreement that “a divestiture of Douglas Aircraft Company (DAC) would be likely to be unsuccessful in preserving DAC as a stand-alone manufacturer of new aircraft, resulting in (...) the loss of employment in the United States” (EC 1997a:para 12). More precisely, after the EC had approved the

⁶⁶ Relative gains considerations were, furthermore, nothing new in analysis of the competition between Airbus and Boeing. Baldwin and Krugman (1988) have shown that the entry of Airbus had a direct negative impact Boeing profits in particular and on the US more generally. Similarly, Klepper (1994) has demonstrated that the main effect of European production subsidies was to transfer learning effects from Boeing to Airbus.

merger, President Clinton said that it would preserve 14000 jobs at DAC (Wall Street Journal 1997). It is reasonable to assume, moreover, that the Europeans could have similar concerns for Airbus workers.

The second step in analysing the validity of neo-mercantilism is to point to factors in the merger analyses that are not readily or entirely explained by (some version of) liberalism, and thus are of particular concern. There are at least two elements in the FTC majority decision that could be questioned. The first was pointed out by dissenting Commissioner Azcuenaga: As long as the vertical agreements foreclosed a much smaller share of the market than what is considered an anticompetitive problem in the US (and this was confirmed by the FTC Chairman and leader of the majority, Robert Pitofsky, in later speeches⁶⁷), it is somewhat perplexing that they were considered “potentially troubling” in the majority statement. Secondly, with respect to the defence aspects of the merger, the FTC found, after close cooperation with the Department of Defence, that it would not create competitive problems in the concerned markets. This may very well be the case, and as the DoD is typically the single buyer it frequently plays a central role in defence merger investigations. What is puzzling, however, is that the FTC leaned so strongly on the DoD, using the fact that the latter “indicated that competition would remain in the defense industry post-merger” as a reason for clearing the deal (FTC 1997). Moreover, as discussed in Chapter 3, the competition agencies had played secondary roles in several defence mergers promoted by the DoD since 1994.

There are three main things to be said about the EC decision. Firstly, it left the defence part of the merger alone, even though several concerns were raised in the May Statement of Objections. Although certain markets were limited to the US and others may not have caused anticompetitive effects, the EC gave no economic arguments for not pursuing its concerns for, e.g., the international fighter aircraft market. Secondly, the significance of the remedies needs to be examined more thoroughly. Although, on their face, they appear appropriate from the objections raised to the merger, knowing that they were accepted just a week before the conclusion of the case and with massive pressure beforehand (see below), they would be vulnerable to political influence.

⁶⁷ See, e.g., Pitofsky 1997b.

Thirdly, ignoring for a moment the official arguments, the beneficiary of the EC decision was undeniably Airbus. This warrants a second look at the EC line of reasoning, this time in light of neo-mercantilism.

According to van Miert (1998), the EC left the defence aspects of the merger alone because it took the “important national interests of the United States into account”. In Brussels, this was presented as a straightforward, almost automatic application of the 1991 Cooperation Agreement. The fact is, however, that it is a *political* decision to apply the traditional comity principle. The agreement as such contains no list of requirements that must be fulfilled or a definition of what should be considered “important national interests”.

After a closer scrutiny and discussions with people close to the process in Brussels and Washington, D.C., some of the key remedies that Boeing acceded to do not appear as straightforward and adequate as a first review may give impression of. *Keeping DAC as a separate legal entity for ten years* is something Boeing would most probably have done in either case, for business reasons and because the State of California, which also had the power to challenge the merger, would most likely have required it because of employment concerns. Moreover, according to Lexecon (1997), in order to restore competition in the aircraft market to pre-merger level, MDD would have to continue to bid as an independent company. The only way to achieve this would be to divest DAC or block the merger; EC’s solution would not be enough to assure autonomous price setting. *Providing high-quality customer support to DAC customers* is again what one would expect Boeing to do for selfish reasons: A customer would probably not buy a Boeing aircraft after just having been treated poorly by the same company. The *licensing agreement* condition has been characterised by DoJ respondents as “irrelevant” and “a symbol” without any practical implications. The *termination of the exclusivity agreements* was the remedy with the potentially greatest impact. Airbus was developing its new super jumbo, the A380, to complete its product portfolio and offer Boeing’s 747-400 competition. Although difficult to assess, it could have been harder for them to launch it had the exclusivity agreements been in place. In sum, advisors close to the merging companies have stated that Boeing would have acceded to the remedies without much hesitation had the EC

presented them up-front. EC officials have also admitted that the remedies may not have been adequate to restore competition and may have been motivated by the need to find a solution. These “weak” remedies are counter-intuitive to neo-mercantilism, but seen in the greater context they may make sense as expressions of economic nationalism (see Section 5.4).

The last step in analysing the potential influence of neo-mercantilist motives is to see the EC and FTC decisions in context and point to other factors that may support or contradict the second hypothesis. At the end of April, when it became evident that the EC may block the merger, Boeing asked officially for the support of the US government, which seemed more than willing to help. President Clinton had previously promised to help Boeing compete for new aircraft sales and criticised his predecessors for not doing enough to assist US firms in restricting Airbus (Lynn 1998:223-6). In this case, the US Trade Representative Charlene Barshefsky raised the issue with Sir Leon Brittan, the EC Trade and former Competition Commissioner, bringing the merger over to the political arena (Reuters 1997). Vice President Gore stated that the US would take “whatever action is appropriate” to prevent the EC from blocking the transaction, and on July 17, he was supported by President Clinton who warned that his administration would retaliate (FT 1997a, b). The list of reprisals included limiting the number of flights between the EU and the US in general, and barring Air France flights from US landings in particular, in addition to less spectacular means like imposing tariffs on European airplanes. Similarly, the US Senate unanimously supported a resolution denouncing the Brussels stance to the merger (FT 1997c).

The US government also exerted pressure on DG Competition in a slightly more subtle way. With reference to Sections VI and VII of the 1991 Cooperation Agreement, top officials from the DoJ and the DoD visited Brussels on July 13, to inform the EC that “a decision prohibiting the proposed merger could harm important US defence interests” (EC 1997a:para 12)⁶⁸. It was considered a case for the executive

⁶⁸ The circumstances surrounding the meeting also make for a fascinating anecdote, although the value as “evidence” is limited. It was revealed in interviews with DG Competition officials and later confirmed by representatives for the US competition authorities that US three-star generals came, together with the head of the DoJ Antitrust Division, to the offices

powers, and, hence, the DoJ replaced the FTC to make the argument. In interviews undertaken by the author, senior US competition officials have made it clear that a full EU prohibition would “not have been acceptable” due to the importance of the defence industry. This makes the threats of retaliation and a trade war all the more likely.

The fact that the EC in the end did leave the defence aspects of the merger alone seems to have had a direct impact on FTC expressing concerns for the supply agreements. Explained FTC General Counsel, Debra Valentine (1997):

“The EC acknowledged important US interests in declining to take any action with respect to defense markets, such as fighter aircraft. The US, in turn, acknowledged what were likely to be EC concerns, by announcing that Boeing's exclusive agreements with airlines were “troubling” and committing to monitor the anticompetitive effects of those and any future long term exclusive contracts.”

Boeing itself also took part on the political stage to get the merger through. As mentioned above, it officially asked the US government for help, and in mid May, a spokeswoman for the company stated that “if the [Federal] trade commission says yes and the European Commission says no, or fines Boeing, it will no longer be a Boeing-EC issue. I think that would elevate it to a trade issue between the United States and Europe” (AFP 1997). Hence, Boeing “wrapped itself in an American flag”, as one critical FTC respondent put it, and posted itself as an official representative or perhaps even a national champion of the US. Moreover, the executive branch did nothing, as discussed above, to tone down that picture.

There were a number of examples of behaviour in the EU as well that cannot be easily explained within a liberal framework. Several European, and particularly French, politicians got involved in the case. The opposition started, according to DG Competition respondents, with a legitimate technical concern, but was subsequently politicised, with politicians taking advantage of the situation to further nationalist goals. After Boeing had offered a first set of concessions, French president Chirac described the merger as an attack on EU commercial interests, and said they should stand firm on blocking it (FT 1997b). Even after the final compromise had been struck, there were signs that the two French commissioners, under government pressure, would not let the deal go through (FT 1997d, e). The Member States also expressed

of the Merger Task Force at 8 a.m. on a Sunday morning, wearing full uniforms, to inform the EC of their point of view. As should be unnecessary to state, this had never happened before, and has never happened again.

their opposition to the merger through the Advisory Committee. It met three times before the case was closed, which is itself unusual, and concluded unanimously in the beginning of July that the merger should be blocked as it looked then.

DG Competition leaders also kept a higher profile than what is common in merger investigations. Shortly after the transaction was announced, and long before Boeing made a European filing, van Miert announced that it would not be approved without substantial concessions. Furthermore, he mobilised all 20 members of the Commission to express their support before the final vote (ICPAC 2000). Other DGs, in particular those for Trade and Industry, were also heavily engaged in the case. Most overt and clearly political was the demand from Trade Commissioner Brittan that the 1992 “peace agreement” had to be renegotiated for the merger to be approved.

In interviews, EC officials also talked about the internal cooperation between the DGs. Generally, all worked “hand-in-hand” and took a common position on the merger. DG Trade was instrumental in the investigation by providing information on spill-over effects, while DG Industry helped explaining the functioning of the market, how it transformed as a result of internationalisation, etc. It was no secret, however, that both had other agendas as well. In the lack of more evidence, though, it is difficult to assess exactly how “neutral” the information was and how it was used.

5.4 Conclusion

In the Boeing/McDonnell Douglas merger case there was disagreement between the US and the EU on several issues and, one could argue, on different levels. The empirical evidence cannot be completely understood from either of the hypotheses alone. It also appears inadequate to explain, e.g., the civil part of the merger with different versions of liberalism and the defence part with neo-mercantilism. Rather, there appear to be interaction effects between the two that are necessary to catch in order to explain the divergent outcomes.

The picture becomes clearer if one accepts two propositions for which there has been given substantial empirical backing above, including direct affirmation by the competition authorities. The first is that the US had a strong interest in seeing the merger go through for military reasons and would, therefore, not under any

circumstances allow the EC to block it. The executive branch, including the President himself as well as the Vice President, the DoD, the DoJ leaders, and the US Trade Representative made this clear in different contexts. This is clearly a neo-mercantilist position. The second is that the EC accepted that the price of defying the Americans on this would be very high while the benefits would be more limited. Such considerations of the costs and benefits for Europe's wealth and power would also be within the scope of neo-mercantilism and lead to a decision taken within those limitations.

It could also be fruitful to direct attention to another point that was discussed only implicitly above: There appears to have been a reduction in autonomy and a following change in who were setting the premises for the outcome during the course of the case. The competition authorities had largely finished their examinations of the facts and the impact of the merger before it became a political matter at the end of April/beginning of May. Up until this point, they seem to have been working without too many interruptions and liberalism in some version appears to have directed their activities. In the final stages of the investigation, the neo-mercantilist dynamics were in place as a limiting structural factor for the competition officials and more explicitly as a motivation for specific actions undertaken by political and state agents. This was brought out in the open when the DoJ assumed responsibility for the case and went, together with the DoD, to Brussels in July; the merger was then a matter for the executive powers. Other examples were given above.

On this background and with the two competing hypotheses in mind, the different aspects of the merger will be briefly revisited. The horizontal effects in the market for large commercial aircraft pose the greatest challenge to drawing definite conclusions. The FTC argued that the MDD had no competitive impact; hence, the merger would not enhance Boeing's (likely) market power to the detriment of consumers. This conclusion, which seems fair, is in accordance with neo-liberalism. The EC agreed that MDD was no competitive force on a stand-alone basis, but argued that it possessed enough tangible and intangible resources to increase the market power of another firm through a merger. As discussed in Section 5.2.3, it is difficult to assess whether the EC position reflected a concern only for consumers or whether it worried about the well-being of Airbus *per se* as well. Hence, its scepticism to the

merger could be in accordance with both neo- and Ordo-liberalism. This poses an analytical problem: The divergent outcomes could be due to different, but reasonable interpretations of facts or to the use of different standards.

The EC position on the horizontal aspects is not clarified by looking at the other liberal factors either: It did not consider whether efficiencies would at all accrue from the horizontal integration of Boeing and MDD and it did not discuss whether the merger would raise entry barriers. The FTC, on its part, did not find the merger to be harmful to consumers. Thus, it saw no need to consider an efficiency defence or to discuss whether entry barriers would be affected. The last two factors, *ex ante* versus *ex post* regulation and time horizon were irrelevant to the horizontal part of the case.

Keeping DAC a separate legal entity does not seem sufficient to fully resolve the EC anticompetitive concerns from the point of view of either of the versions of liberalism. When considered in light of the limitation that the merger could not be blocked and there were no other buyers for DAC, however, the outcome appears the best that could realistically be obtained.

With respect to the conglomerate aspects of the case, the versions of liberalism hypothesis seems to provide more unambiguous conclusions than is the case for the horizontal aspects. The EC considered the conglomerate effects, including those that could arguably enhance efficiency, to increase the dominance of Boeing and, hence, damage competition. The FTC did not find any of the EC arguments a cause for worries. Rather, financial stability, pricing flexibilities, and commonality benefits were seen as efficiency gains to the benefit of consumers. The somewhat inadequate EC-imposed remedies can be well explained by the neo-mercantilist structural limitation.

The EC position on the vertical supply agreements could also be largely explained from an Ordo-liberal rationale. Despite the fact that they may have created efficiency gains, they would foreclose some of the market to the advantage of what was perceived to be an already dominant firm. The effect would have been to make new entry even less likely as well as causing harm to the *actual* competitor, Airbus. The EC made this decision *ex ante*, and did not wait to see whether the effects would materialise before acting. In light of the first hypothesis, the FTC approached the agreements with what appeared to be great confusion: While they were not believed to

create anticompetitive harm or break the law, the majority concluded that they were “potentially troubling”. The former stand would be in accordance with neo-liberalism; the latter reflected the EC’s point of view. The illogical combination is best explained as part of a trade-off in return for the EC’s decision to leave defence markets alone.

With regards to these defence markets, the US and the EU did not disagree in the end. At the time of the Statement of Objections, however, the EC expressed worries with certain international products. The lack of detailed information makes it difficult to assess on what grounds this result was reached. The FTC argued that the merger created no anticompetitive effects; the above analysis showed that this decision was based as much on DoD’s call for strategic restructuring and consolidation as on an economic assessment, however. The final conclusions of the agencies then clearly seem to have been motivated by neo-mercantilism.

Overall, the EC review of the conglomerate and vertical, and possibly horizontal, aspects of the case appear to be in accordance with Ordo-liberalism; much of the FTC examination done by the staff seems to be close to a neo-liberal rationale. This is as expected by the first hypothesis. The assessments leading to these outcomes were largely made during the early period of the merger review process. During this time, the agencies were allowed to work relatively autonomously and seem to have set the premises for the conclusions that were drawn. In the final stages of investigation, politicians, state agents, and economic nationalism took over. The puzzling FTC stance on the vertical agreements and its trust in the DoD for evaluating the defence markets, together with the EC decision only to pursue its concerns for the commercial aircraft market and subsequent moderate remedies, are all in accordance with the second hypothesis.

Chapter 6. The GE/Honeywell merger

On October 22, 2000, the General Electric Company (GE) announced its intention to acquire Honeywell International, Inc. (Honeywell) for USD 42 Billion. GE is a conglomerate, active in a number of fields including aircraft engines, power systems, plastics, transportation systems, medical systems, broadcasting and financial services. Honeywell is involved in aerospace, transportation and power systems, specialty materials, and automation and control systems. The combination of the two would account for the largest industrial merger ever. The Antitrust Division of the DoJ, which was the responsible agency in the US, started its investigation at the end of October 2000 and approved the merger on May 2 the following year, only requiring two minor remedies (see below). The EC opened its investigation on February 5, 2001, after long and detailed pre-notification discussions with the merging parties, and concluded on July 3 that the merger was “incompatible with the common market” (EC 2001c:para 567). Hence, for the first time ever the EU competition authority had blocked a merger between two American companies that the US authorities had approved. It was therefore hardly surprising that the reactions were many and at times harsh, coming from politicians, the private sector, academics, as well as the competition authorities themselves.

The size and complexity of the merger case gave rise to a number of possible anticompetitive concerns. It affected several product markets and could potentially have negative horizontal, vertical and conglomerate effects. The following analysis will, in line with the focus of the thesis, centre on the aspects of the case that created the largest controversy between the competition authorities: conglomerate and vertical effects in the markets for aircraft engines and for avionics and non-avionics systems. There were remarkably few horizontal concerns and, according to EC and DoJ officials, they could, to the extent that they existed, have been easily resolved through remedies. For the same reason, the markets for industrial products like small marine

gas turbines, which in either case accounted for only a small part of the merger, will be excluded, as will some markets that were limited to only one jurisdiction⁶⁹.

6.1 *Pre-merger Situation: Market Definition and Entry Conditions*

6.1.1 Market Definitions, Firms and Industry Concentration

As discussed in Chapter 3, the analysis of a merger case begins by defining the relevant markets in terms of products and geographic extension and identifying the participants and degree of concentration in each market. The US and EU competition authorities agreed on the former and examined “identical product and geographic markets” (DoJ 2002:225). Disagreement began, however, with the assessment of GE’s position in the market for aircraft engines.

The Market for Aircraft Engines

Three sub-segments of the world-wide engine market created particular concerns, namely the markets for large commercial aircraft engines, large regional aircraft engines, and medium corporate jet aircraft engines.

In the markets for large commercial and large regional aircraft engines, GE was the leading player, followed by Pratt & Whitney (P&W) and Rolls Royce (RR). Two smaller firms, which would prove to have significant impact on the analysis, were CFMI, a 50/50 joint venture between GE and its French subcontractor SNECMA, and IAE, a 50/50 joint venture between P&W and RR. The EC claimed that GE was dominant in both markets; the DoJ disagreed. As the analysis was parallel for both markets, the current discussion will be limited to large commercial aircraft engines.

The disagreement began with the calculation of market shares. The EC included all engines sold by CFMI in the GE share, while the sales of IAE were split evenly between P&W and RR. The argument for treating the joint ventures differently was that SNECMA had no independent presence in the market and “would act jointly with the GE as a profit maximising entity” (EC 2001d:6). As table 6.1 shows, GE was the largest company in the market, which led the EC (2001c:para 83) to conclude that “GE

⁶⁹ One example is the market for military helicopter engines, which was limited to the US. The DoJ’s assessment of this market will be discussed in some detail in the section on neo-mercantilism.

enjoys a strong position, indicative of dominance, in the supply of jet engines for large commercial aircraft”.

Table 6.1. Installed Base and Order Backlog of Engines on Large Commercial Aircraft still in Production on 31 Dec. 2001 and 01 Jan. 2002, respectively. %.

| | Installed base | Order backlog |
|--------------------|----------------|---------------|
| GE/CFMI | 52.5 | 65 |
| P&W/IAE | 26.5 | 16 |
| RR/IAE | 21 | 19 |

Source: EC 2001c:paras 70, 77

The DoJ disagreed with the EC on several grounds. Most importantly, it argued that the engine market for large commercial aircraft was a “bid market with three strong competitors” and that “historic market shares are only weakly indicative of future success” (DoJ 2002:225). It substantiated the claim by referring to the large discounts frequently given on engines and by showing that contracts awarded in the first half of 2001 had been more evenly split between GE (42 per cent), P&W (32 per cent), and RR (27 per cent) (Kolasky 2001:11).

The DoJ also questioned the EC approach to the actual measurement of market shares. Firstly, GE’s share depended for a large part on an exclusive supply contract with Boeing for 737s⁷⁰. Excluding those sales would yield the following market shares, measured in terms of order backlogs (per cent): GE: 44, P&W 23, and RR 27 (Kolasky 2002:10-11). Secondly, the DoJ argued that the sales of CFMI engines should not automatically be attributed to GE. As will be discussed in detail below, one of EC’s theories of harm was that the merged entity would engage in bundling. As SNECMA is a principal competitor to Honeywell for landing gear, the DoJ questioned why it would agree to cut the price of its engines to increase Honeywell sales (Kolasky 2001:11). Hence, the DoJ (2002:225) concluded that there was “no basis, therefore, for finding that GE would be able to impose restrictions on its engines customers”.

Beyond the size of the market share, the EC claimed that two GE divisions, GE Capital and GE Capital Aviation Services (GECAS), contributed to GE’s dominance

⁷⁰ These engines are contracted at a pre-determined price and could, according to the DoJ, thus not be used as a tool for exercising market power.

in the engine market. The DoJ assessed their competitive impact differently. GE Capital, the financial arm of the GE group, accounted for about half of the conglomerate's revenues and managed about 80 per cent of its assets at the time of the merger. The EC made several related arguments about how these "enormous financial means" could be, and had indeed *been* used to the benefit of GE's engine sales. Firstly, it offered GE access to financing almost instantaneously, allowing it to take more risk in product development programmes and "absorb potential product failure and strategic mistakes" (EC 2001c:para 110). Secondly, the GE used heavy discounts on the initial sale of engines, moving the break-even point for engine projects away from the commercial launch of a platform. The EC argued that this increased rivals' funding costs by delaying their inception of cash flows, and, hence, increased their need to resort to external financing. The result was higher debt/equity ratios and increased borrowing costs (ibid:para 111). Thirdly, GE provided financial platform-programme development assistance to airframe manufacturers. According to the EC, GE had used this in the past to get exclusivity for its products on platforms, foreclosing rivals' access to the airframes. Lastly, the EC asserted, "GE also uses its financial strength to influence airlines in their purchasing behaviour by injecting capital into their activities at critical times" (ibid:para 117).

The DoJ, on the other hand, found great financial resources to be neutral or even positive to competition in a two-fold argument. Firstly, it is not given that any division of a conglomerate will have cheaper access to capital than rival firms: Capital markets generally work very efficiently and rivals should have access to funding at about the same terms as GE/Honeywell; moreover, there are many uses for capital in a firm, and committing it to one project involves opportunity costs because the capital is not available for other projects. Secondly, even if GE/Honeywell would get cheaper access to capital, the DoJ regarded it as just another source of efficiency, as it would serve to lower prices and promote innovation. (Kolasky 2001:15-6)

The second factor considered by the EC to contribute to the dominant position of GE was its integration into aircraft purchasing, financing and leasing through

GECAS⁷¹. GECAS was the world's largest purchaser of new aircraft, although it held less than ten per cent of the total market. Despite this modest share, what made it a unique "tool" for GE was, according to the EC, its policy of buying only GE engines⁷². The EC claimed that this had helped enhancing the market position of GE mainly in three ways. Firstly, the EC argued that GECAS was a "launch" or "boost" customer. Hence, it could influence aircraft manufacturers' equipment selection and "tilt" the balance in favour of GE engines. This is particularly important in obtaining exclusive access to new platforms. Secondly, GECAS could influence airlines to choose GE engines on platforms on which there were options by offering beneficial financing, leasing, and fleet management (EC 2001c:paras 134-6). The third reason offered by the EC was that GECAS could shift market shares in favour of GE by "seeding" airlines with GE-powered aircraft. Given the benefits of commonality⁷³, this could create a multiplier effect with airlines demanding more GE engines in the future (ibid: paras 126, 136). Importantly, the EC did not find it credible that GE's competitors would be able to replicate the advantages from GECAS easily and rapidly.

The DoJ objected to the EC assertions on several grounds. Most importantly, GECAS' share of total aircraft purchases was smaller than what is considered necessary to engage in effective foreclosure practices (DoJ 2002:226). As discussed in Chapter 3, US case law typically requires market shares of at least 20 per cent before finding potential foreclosure. The DoJ also did not find EC's "tipping argument" credible. Firstly, the rational response of rival leasing companies would be, according to the DoJ, to differentiate themselves from GECAS by purchasing relatively more non-GE powered aircraft⁷⁴. The DoJ found several empirical examples of such behaviour (Kolasky 2001:18). Secondly, the DoJ doubted that GECAS could "seed" airlines with GE engines. As evidence it argued that 90 per cent of the world's aircraft were in mixed fleets and that GE/Honeywell's rivals could achieve the same effect by offering discounts on their engines:

⁷¹ The EC reported this as a case of vertical integration, while the DoJ (2002:226) claimed that it, due to the financing aspect, could just as well be considered a conglomerate issue. Whatever label is used, the argument remains the same.

⁷² The one exception is engines for eight Boeing 757s for which GE has no engines to offer.

⁷³ See section 5.1.2 in the analysis of the Boeing/McDonnell Douglas merger.

⁷⁴ If competitors offer identical products, explains neo-liberal economic theory, they will never experience a profit.

“It makes no difference analytically whether GE is able to sell engines based on (1) a low lease rate from GECAS or (2) a low engine price. A low lease rate is simply another form of discount. To the extent airlines prefer discounts in this form, rival equipment suppliers could partner with leasing companies to offer favorable lease term for aircraft equipped with their engines.” (ibid.)

Lastly, the DoJ disagreed with the EC’s “share shifting” argument, claiming that the GE had won competitions to become an exclusive supplier on merits, with GECAS playing no role whatsoever (ibid:18-9).

The competition authorities also disagreed on the ability and willingness of GE’s customers to exercise buying power. According to the EC (2001c:paras 224-8), both aircraft manufacturers and airlines were too dependent on the advantages obtained through GE Capital and GECAS’s business practices to risk losing their relationship with GE. The DoJ had more faith in the countervailing powers and argued that customers would react if they saw attempts to monopolise the engine market (DoJ 2002:226).

In conclusion, the EC (2001c:para 229) maintained that given

“GE’s incumbent position with many airlines, its incentive to use GE Capital’s financial power with customers, its ability to leverage its vertical integration through GECAS, the limited countervailing power of customers and the weakening or marginalisation of its direct competitors, GE appears to be in a position to behave independently of its competitors, customers and ultimately consumers and can thus be characterised as a dominant undertaking on the markets for large commercial jet aircraft engines and for large regional jet aircraft engines.”

The US response to the EC claim was short but concise: “We found little support for that argument” (DoJ 2002:225).

In the last segment of the engine market, the one for medium corporate jet aircraft engines, the competition authorities agreed that Honeywell was the leading player, but without being dominant (EC 2001c:paras 88-9). Its main competitors in that market were GE, P&W and RR.

The Market for Avionics and Non-avionics Products

Avionics products are equipment used to control the aircraft, for navigation and communication as well as for assessing flying conditions. Non-avionics products include auxiliary power units, electric power, wheels and brakes, environmental control systems, landing gear, and aircraft lighting.

A distinction can be made between buyer-furnished equipment (BFE), which is equipment selected by the buyer of an aircraft (e.g., an airline) at the time of the

purchase, supplier-furnished equipment (SFE), i.e., equipment selected by the airframe manufacturers at the time of the development of a new platform, and SFE-option, where the airframe makers certify several products between which the buyer may choose. For the discussion below, it is important to note that SFE is typically selected for a whole platform on an exclusive basis.

Honeywell was the largest firm in the global avionics market, with an overall market share of over 50 per cent. Its two main rivals, Rockwell Collins of the US and Thales of France, together accounted for about 40 per cent, while 35 producers shared the rest of the market. Honeywell was also the leading player in the world-wide market for non-avionics products, with a market share of between 40 and 70 per cent depending on product line (EC 2001d:8). The main competitor was Hamilton Sundstrand while several other firms – including SNECMA – offered a limited range of products.

The EC noted that Honeywell could supply full product lines of both avionics and non-avionics systems, something no competitor, at the time of the proposed merger, could do (EC 2001d:9). There was, however, no disagreement between the EU and the US competition authorities with respect to these findings, and hence, no further discussion is warranted at this point.

6.1.2 Entry Conditions

The market for aerospace products, be it aircraft engines or avionics and non-avionics systems, share some of the same features as the aircraft market examined in the Boeing/McDonnell Douglas merger: large R&D investments are required, much of which will be unrecoverable, and the long lead-time for new aircraft platforms would be at least partly reflected in the demand for equipment, in particular for engines and SFE avionics and non-avionics. Hence, the industry is characterised by significant barriers to new entry or re-entry after exit. The competition authorities shared this understanding. As there were several competitors in all the concerned markets at the time of the merger, the central question rather became whether exit would occur in the first place.

6.1.3 Summary of the Pre-merger Situation

As should be evident from the above discussion, the EC and the DoJ interpreted the situation in the markets for aircraft engines and avionics and non-avionics products significantly differently. The EC saw a dominant firm in engine production merge with the leading player in the market for complementary avionics and non-avionics systems in industries characterised by high barriers to entry and few possibilities for customers to exercise countervailing power. While agreeing that new entry would be difficult, the DoJ painted a less dramatic picture of the market situation prior to the proposed merger. GE had two strong competitors in a bid market for aircraft engines and did not enjoy a dominant position. Honeywell was the largest firm in the avionics and non-avionics markets, but that alone did not warrant any concerns. Moreover, the DoJ believed that competitors and customers were so strong that neither of the merging firms could act independently without losing market shares. The different opinions coloured the rest of their analyses, but the disagreement did by no means end there.

6.2 Effects from Merger: Theories of Harm and Mitigating Factors

6.2.1 Theories of Harm

The EC presented two main avenues of harm in its Final Decision: Foreclosure through mixed bundling⁷⁵ and through “the vertical integration of Honeywell with GE”, with weight on GE Capital’s financial strength and GECAS’ “GE only” policy⁷⁶, both of which the EC argued would be extended to Honeywell after the merger.

Below, each will be discussed separately, as will the likelihood of rivals’ exit.

Thereafter, factors that could mitigate any anticompetitive effects from the merger will be discussed: customers’ buyer power, efficiency gains and remedies. The underlying logics of the arguments were the same for engines and for avionics and non-avionics products. Hence, they will be presented as a whole, allowing for distinctions to be made where relevant.

⁷⁵ The EC also briefly discussed the possibility that GE/Honeywell could engage in technological bundling or tying. These arguments were, however, less central to its decision to block the merger. For this reason and the fact that the line of reasoning was similar to that for mixed bundling, it will not be included in the analysis below.

⁷⁶ In the market for corporate jet aircraft engines, GE Corporate Capital Aviation Services (GECCAS) would take the role that GECAS had in the large commercial and regional aircraft markets, producing, however, the same outcome (EC 2001c:paras 438-42).

Foreclosure through Bundling

The EC feared that, post-merger, GE and Honeywell would sell packages of complementary products, in particular engines and avionics and non-avionics systems, at lower prices than pre-merger⁷⁷. As rivals would not be able to match these bundles, customers would buy more GE/Honeywell products. Competitors would experience a loss in market shares and profits, resulting in reduced competition and eventually exit of competitors in the medium term (EC 2001c:para 354). Thereafter, the merged firm could raise its prices and earn a monopoly profit.

In its Final Decision, the EC refused to connect this mixed bundling argument with any specific economic model (see section 6.3)⁷⁸. This obviously makes it more difficult to assess its validity. The fundamental logic, however, warrants inquiries on two levels. Firstly, there is the question of whether the argument is in accordance with an efficiency-targeted economic theory; secondly, one should ask whether a mixed bundling strategy would be valid for the aircraft industry at all.

The EC alleged that a united GE/Honeywell could offer bundles of products at discounted prices. As discussed on a general basis in Section 2.2.5, this is the expected outcome when two firms with (some) market power producing complementary products merge, as they will have the incentive to internalise pricing externalities, i.e., what is known as the Cournot effect. In practical terms, this means that by reducing the price of its engines post-merger, GE/Honeywell will increase the sales of its avionics and non-avionics products, because they are complementary to engines (and *vice versa*). The EC argued that the expected price reduction would also be a result of “cross-subsidisation”⁷⁹, but did not explain how this would be detrimental to consumers in the short run. Under both EU and US competition laws, only predation is illegal, and the EC did not claim that the merged firm would use that pricing strategy.

⁷⁷ The EC also displayed some concerns that GE could leverage its position in engine maintenance, repair and overhaul (MRO), to Honeywell after the merger (EC 2001c:paras 90-106). This did not have an independent impact on the analysis, however, and was just another factor to consider. Moreover, the DoJ found that the merger would substantially lessen competition in certain aspects of this market and required the parties to “authorize a new third-party MRO service provider” (DoJ 2001). As this aspect of the case was of minor importance and the competition authorities agreed on its impact on competition, it could not help explaining the divergent conclusions they reached in the end. Hence, the MRO market will not be included in the rest of the analysis.

⁷⁸ In its Statement of Objections, however, the EC relied on a model developed by Jay Pil Choi (2001) for Rolls Royce. The main opposing theory came from Barry Nalebuff (see, e.g., Lu and Nalebuff 2001 and Nalebuff 2002), who was hired as a counsel for GE. The DoJ leaned towards Nalebuff’s arguments.

⁷⁹ See, e.g., EC 2001C:paras 349, 353, 379, 398, 432.

Thus, the short-term effect of the merger would be to create a more efficient firm that could offer lower prices to the benefit of its customers. As asserted in the OECD report on portfolio effects, for harm to result then, competitors would have to lose profits and exert less competitive pressure or even exit the market. A central question then becomes whether competitors could engage in strategies that could countervail the alleged market power of a merged GE/Honeywell⁸⁰. A general discussion of the position of competitors will be undertaken below; here, focus will be on one reaction relating directly to mixed bundling.

One could imagine that competitors to GE/Honeywell could offer counter-bundles, either through internal development or through teaming arrangements. As discussed in Section 2.2.5, the welfare effects from bundle-against-bundle competition are unambiguous: Consumers would gain at the cost of producers. Hence, if this were a realistic option, possible bundles from the merger should be welcomed, not opposed. The EC did not, however, consider it a credible strategy. Although attractive product packages could be assembled, “in the absence of economic integration among competing suppliers, the prices of their bundles cannot be expected to be lower than those of the merged entity. (...) Teaming has therefore to be disqualified as a viable alternative to the merged entity’s ability to profitably bundle products and services from its extensive product range” (EC 2001c:paras 378-9).

This conclusion diverged from the one the EC had reached two years earlier when it approved the Honeywell/Allied Signal merger⁸¹. Assessing the avionics market, it had asserted that

“there is scope for competitors to extend their product range, either via internal development of products or by “teaming” with other competitors. Although competitors have pointed out that teaming is not an alternative, on account of the extra cost and organisation involved, it is considered that teaming can still be a realistic alternative.” (EC 1999:para 118)

The DoJ claimed that there were also several similar examples of teaming in the market for large commercial aircraft engines. In particular, it mentioned three joint

⁸⁰ There was also factual disagreement between the EC and the merging parties as to whether mixed bundling had taken place in the aerospace industry in the past (EC 2001c:paras 361-70). Although the DoJ did not take a clear stand on this, it did state that there was no evidence that firms had used bundling successfully to gain market shares (DoJ 2002:225).

⁸¹ *Allied Signal/Honeywell*, Case COMP/M.1601 (1999), OJ C215.

ventures: CFMI, IAE, as well as GE and P&W's collaboration to develop engines for Airbus' A3XX and Boeing's projected B747 (DoJ 2002:231n52).

On a different level, one could question whether a mixed bundling model is at all applicable to the aerospace industry. Whereas the EC asserted that GE/Honeywell would have a clear incentive to bundle its products post-merger, the DoJ questioned this, based on the findings of Barry Nalebuff (Kolasky 2001:12). The effects of bundling depend critically on the assumption that all customers are initially offered uniform prices. As discussed in the Section 2.2.5, bundling thus becomes a way to price discriminate between customers. In the aerospace market, however, prices are negotiated on a customer-by-customer basis (Nalebuff 2002:15). Hence, one could argue, as did the DoJ, that the incentive to bundle diminishes or even disappears, as the full benefit of discrimination is exhausted through negotiations (Kolasky 2001:12).

Foreclosure through the Vertical Integration of Honeywell with GE

Another of the EC's avenues of harm was based on the perceived advantages of transferring GE's financial strength to Honeywell. The EC argued that, immediately post-merger, Honeywell could take advantage of GE Capital's incentive and capability to secure exclusive supply positions for SFE avionics and non-avionics systems as well as for corporate aircraft engines, applying the same business strategies as the GE had used in the past. Somewhat coinciding with its bundling argument, the EC also asserted that Honeywell would have been in a position to "cross-subsidise its different business segments"⁸² (EC 2001c:para 345).

The DoJ equalled the EC's approach with the so-called "entrenchment doctrine". This doctrine argued that mergers should be prohibited if they could hurt smaller competitors by strengthening an already dominant firm through greater efficiencies, or by giving the acquired firm access to a broader line of products or greater financial resources (DoJ 2002a). It was discredited in both neo-liberal economics and US antitrust guidelines in the late 1970s/early 1980s. This, together with the assertions that competitors would have as easy access to cheap capital as

⁸² In the explanation offered in the EC Competition Policy Newsletter by the MTF team working on GE/Honeywell merger, the same sentence is used, but extended to "including the ability to engage in predatory behaviour" (Giotakos et al. 2001:10). If this claim were substantiated, it could have turned the case also for the US.

GE/Honeywell, and if they did not, cheap capital should be considered an efficiency, led the DoJ to conclude that GE Capital's resources would have neutral or positive effects on the merger.

The EC also asserted that the merger could give rise to anticompetitive effects by allowing Honeywell to take advantage of GECAS's position to secure exclusive supply contracts for Honeywell's SFE avionics and non-avionics systems by adopting a "Honeywell only" policy (EC 2001c:paras 344, 410). Honeywell sales of engines for corporate jet aircraft would similarly benefit from the position and business practices of GECAS (see footnote 76). As the DoJ did not find that GECAS had foreclosed GE's engine competitors, the possible extension of its business practices to Honeywell would not create any further concerns.

Effect on Competitors

As discussed above, the short term effect of the merger would be lower prices. Hence, in order for the merger to have an overall negative impact, it would have to reduce competition in the longer run. For this to happen, not only would the EC's theories of harm have to be correct; competitors would also have to be put in a position where they could no longer compete effectively or even were forced to exit markets. The EC and the DoJ disagreed on the feasibility of this outcome.

Post-merger, one should expect competitors to engage in strategies that could counter GE/Honeywell's business practices. Above, the option of offering counter-bundles was discussed. Two further reactions would be even more typical: to increase quality and/or to lower prices. The DoJ found both options likely. Although the EC did not seem to disagree, it argued that the benefits accruing from any such practice would be far too small to withstand the advantages that GE/Honeywell would achieve through the merger. E.g., it asserted that "GECAS's significant volume of purchases indeed makes it more difficult for rivals to develop effective counter-strategies since the profit on even a handful of additional aircraft sales would outweigh the additional profits from even dramatic price cuts on [avionics and non-avionics] systems by the merged entity's rivals" (EC 2001c:para 453).

Hence, the EC did not see any other outcome from the merger than a reduction or even elimination of competition. The post-merger mixed bundling strategy would affect rival suppliers of BFE and SFE-option products on existing platforms immediately as they are traded on a regular basis. Similarly, rival producers of SFE systems and engines would be foreclosed from new platform competitions⁸³. The effect would be to deprive them of market shares and revenues. In the medium to long run, competition would decrease and competitors would most likely be forced to withdraw from the markets (EC 2001c:paras 349, 355, 416, 434, 443).

The leverage of the strength and business practices of GE Capital and GECAS to Honeywell would also foreclose competitors, to the degree that they would have to assess the sensibility of staying in the markets. The EC foresaw this process to evolve in the following way:

“The effect on rival avionics and non-avionics [and engines] manufacturers will be to deprive them of the future revenue streams generated by the sales of the original equipment and spare parts. Future revenues are needed to fund development expenditures for future products, foster innovation and allow for a potential leapfrogging effect. By being progressively marginalised as a result of the integration of Honeywell into GE, Honeywell’s competitors will be deprived of a vital source of revenue and see their ability to invest for the future and develop the next generation of aircraft systems eventually eliminated.” (ibid:para 347)

After the reduction or elimination of competition, the EC claimed that GE/Honeywell was free to raise prices above marginal costs and earn a monopoly profit. The DoJ strongly disagreed with this conclusion, and summed up its argument as follows:

“We found no evidence supporting the notion that competitors would not be able to keep up or would be forced to exit as a result of the merger. GE’s and Honeywell’s rivals are mostly large, financially healthy companies with large shares in many of the relevant markets and ready access to capital. Since the engines and avionics and non-avionics systems have already been selected for all existing airframe platforms, and since very little or no new platform competition is expected in the near term, these competitors have an assured revenue stream for many years and any exit scenario seemed wholly implausible. We found no historical evidence of aerospace firms exiting or withdrawing from the market because they could offer only a narrow range of products, other than through mergers which kept their productive assets in the market.” (DoJ 2002:226)

⁸³ The weakest part of this argument seems to be the bundling of avionics and non-avionics systems and engines for corporate aircraft, as all products are manufactured by Honeywell. The EC justifies the claim by asserting that maintenance and other after-market services would be included in the bundle (EC 2001c:para 443). It is also possible to imagine that Honeywell did not find it lucrative to offer bundles prior to the merger, but after the transaction, it may be included as a part of a greater business strategy.

6.2.2 Mitigating Factors

Customers' Buyer Power

Even if it were true that competitors could not withstand the pressure from a united GE/Honeywell, it is possible that customers could help restricting their predicted market power. Also on this point, the US and EU competition authorities disagreed.

The EC did not find it likely that customers would exert buyer power. Firstly, they would lack the incentive to do so as post-merger prices would drop, not increase. Moreover, even though both airframe manufacturers and airlines would prefer competition to be maintained over the longer term, their immediate concern would be for short term costs. Hence, asserted the EC, they would not choose a less integrated supplier with higher prices as it would disadvantage them compared to their competitors⁸⁴. Related to this argument, the customers were also too dependent on the advantages offered through the business practices of GE Capital and GECAS, e.g., to finance platform development or to place launch orders, to give them up. (EC 2001c:paras 445-57)

The DoJ, on the other hand, believed that if GE/Honeywell would indeed obtain market power, customers would be ready to react. As discussed above, rival leasing companies had already differentiated themselves and purchased more non-GE engines, and even though no single airline may be eager to provide the common good of maintaining competition, Boeing and Airbus probably would. Each had a large market share (they had in fact become more even since the 1997 merger) and could afford to take on the extra load of maintaining competition (DoJ 2002:226).

Efficiency Gains

Throughout the analysis, efficiency gains have been touched upon more or less explicitly. There is a need to evaluate them more systematically, however, especially since the approach to efficiencies is a key difference between neo- and Ordo-liberalism.

⁸⁴ This situation resembles what in game theory is known as “the tragedy of the common” (Hardin 1968). Although examples typically relate to natural resources (e.g., grazing lands, fisheries), the underlying logic could be stated more generally: Individual incentives surrounding certain goods discourage collective action and could often lead to the destruction of the good itself.

The clearest and most certain efficiency gain from a GE/Honeywell merger would have been the internalisation of pricing inefficiencies. Both competition authorities agreed that prices would in fact decrease in the short term due to the merger, and the gains are by definition transferred to consumers. As discussed above, the question rather became whether competition would decrease or be eliminated due to the lower prices, which could have anti-competitive effects in the medium to long run. The EC made no effort to quantify the size and duration of the price reductions and estimate the following price increase, which could have laid the basis for a concrete trade-off between short-term gains and longer-term losses. The DoJ focused on the relative certain short-term gains and attached less weight to any possible longer-term negative effects, which it in any case did not believe would materialise.

There was less agreement on how to treat Honeywell's access to GE Capital. As discussed in Section 2.2.5, conglomerate firms could serve as miniature capital markets under the control of informed managers. Moreover, the capital would be exposed to internal competition. Both these arguments, which were picked up by the DoJ, serve to increase efficiency. The EC, on the other hand, claimed that the cheap capital could be used for anticompetitive purposes.

In his autobiography *Jack: Straight from the Gut*, Jack Welch, then CEO of GE, claimed that further efficiencies could be reaped by improving the management of Honeywell, including "pushing more aggressively into services, and adding Six Sigma and e-business initiatives to Honeywell's operations. We figured on \$1.5 billion in savings from these initiatives and other productivity measures" (Welch 2001:362). As discussed in Chapter 2, managerial efficiencies could arise from conglomerate mergers, but it is very difficult to estimate the exact figures and whether the gains would in fact be passed on to consumers⁸⁵. Moreover, GE did not make this claim to the EC case team, apparently because they were afraid that it would be treated as a reason to *prohibit* the merger⁸⁶. The DoJ did not seem unsympathetic to the GE claim,

⁸⁵ The allegation that gains would accrue from implementing Six Sigma, a data-driven management system, at Honeywell is at best dubious. Six Sigma is developed by Honeywell, not GE, and to the extent that it was not fully implemented, it is likely that it would have been in the future, independent of the merger.

⁸⁶ This "efficiency offence" hypothesis was introduced to the author by officials of the Antitrust Division at the DoJ.

but as it did not consider the merger to be anticompetitive, it made no attempt to quantify the gains.

Remedies

The DoJ required only two remedies to approve the merger: the establishment of a new third-party maintenance, repair and overhaul service supplier and the divestiture of Honeywell's military helicopter engine division. Both, which are discussed elsewhere in this analysis, were readily accepted by GE/Honeywell.

The EC required larger remedies were it to let the deal go through. On June 14, 2001, the merging parties proposed a first set of undertakings in most of the fields that had caused the EC concern, including structural remedies for avionics and non-avionics products and large regional jet engines, and behavioural undertakings for corporate jet engines, GECAS and a promise to not engage in bundling. The EC (2001c:para 486) considered these actions "insufficient to eliminate the major competitive problems identified on engines for large regional commercial aircraft, avionics and non-avionics." Two weeks later, GE/Honeywell proposed a new set of undertakings, in particular relating to GECAS, but the EC did also not find these sufficient to mitigate the anticompetitive effects of the merger (ibid:paras 534-63).

6.2.3 Summary: The FTC and EC Decisions in Light of the Five Liberal Factors

To sum up the above analysis, the FTC and EC Decisions will be briefly examined according to their stands on the five liberal factors first presented in Section 2.1.1. A more full-fledged conclusion will be offered in Section 6.4. The first point where the authorities took different approaches concerned *whom to protect*. This was most clearly displayed in the assessment of bundling. While both agreed that this practice would give the merging firms an advantage over their competitors, the DoJ was content when it had established that consumers would benefit from lower prices. The EC, on the other hand, was also concerned about the well-being of competitors as such.

Secondly, as discussed in detail in Section 6.2.2, the two competition agencies took very different approaches to the *efficiency gains* that could accrue from the merger. The DoJ was positive; the EC argued that they could be used to force

competitors out of the market. Thirdly, the EC argued that the large financial resources of GE, which would be extended to Honeywell post-merger, would raise *barriers to entry*. The DoJ disagreed. With regards to the two last factors, *ex ante* versus *ex post* regulation and *time perspective*, there was also cross-Atlantic disagreement: The EC was so concerned about the long-term effects of the merger that it found it required to block the deal *ex ante*; the DoJ, on the other hand, focused on the lower prices the merger would produce in the short-term.

6.3 The Case for Neo-mercantilism

The second hypothesis for explaining different outcomes is concerned with neo-mercantilism trumping (some version of) liberalism. The three-pronged approach suggested earlier will again be applied, focusing on the “likely case” for neo-mercantilism, weaknesses in the economic assessment, and circumstantial evidence.

With two American merging parties, the neo-mercantilist expectation is that the EC should be sceptical and the US positive to the deal. A “problem”, however, was the lack of champions to protect. Rolls Royce of Great Britain and Thales of France would both be negatively affected by the merger, but so would several US firms. GE, Honeywell and French SNECMA, through its joint venture with GE, would probably benefit. Furthermore, none of the market structures were conducive to strategic trade policy.

The affected markets for aircraft engines and avionics and non-avionics equipment have some of the features of the aircraft market discussed in the BMDD case: It is a high-tech industry with several potential spill-over effects, including to the defence industry. In the GE/Honeywell case, the US market for military helicopter engines would be directly affected by the merger as the merging firms together accounted for a large share of the market⁸⁷. The DoJ worked closely with the DoD throughout the investigation and both agreed that the horizontal overlap would have lessened competition substantially. Thus, the DoJ required that Honeywell’s helicopter

⁸⁷ As discussed in the introduction of the case, this market was excluded from the previous analysis as it only affected the US jurisdiction and was not a source of disagreement for the competition authorities.

engine division should be divested (DoJ 2001). This outcome is the opposite of what one should expect had it been dictated by neo-mercantilism.

The merger's effect on labour would rather be negative than positive. Much of the cost savings from the merger were to be realised through job cuts; some analysts estimated that as many as 75,000 employees would be laid off (Business Week 2001; CNN 2001a). If the DoJ were primarily concerned with economic nationalism, it may have considered blocking the merger, not approving it. In interviews with both DoJ and EC officials, labour concerns were written off as as "irrelevant" for the analyses.

The second element to consider when assessing the possible role of a neo-mercantilist rationale is weaknesses in the economic arguments. The portfolio effects theories were not introduced until the 1990s, are still under development, and have not been applied to many cases. That should give the competition authorities more room to manoeuvre and increase the possibility for other concerns than economics to play a role. Reaching beyond their novelty, the EC displayed a casual approach to the theories:

"[T]he Commission has evaluated the theoretical premises of mixed bundling as presented to it in the economic analyses submitted by the parties and third parties. The various economic analyses have been subject to theoretical controversy, in particular as far as the economic model of mixed bundling, prepared by one of the third parties, is concerned. However, the Commission does not consider the reliance on one or the other model necessary for the conclusion that the packaged deals that the merged entity will be in a position to offer will foreclose competitors from the engines and avionics/non-avionics markets. (EC 2001c:para 352)

Although, as shown above, there is an economic rationale behind the EC argument, refusing to rely on an explicit economic theory decreases transparency and the possibility for checking the analysis and, hence, increases the room for speculation. Moreover, Nalebuff raised the question of whether any bundling theory would be valid for this industry at all since contracts are negotiated on a customer-by-customer basis. Despite the limited number of DoJ publications on its decision, there are no evident deviations from neo-liberal economic theory, an impression strengthened in the interviews undertaken by the author.

There were, however, factors surrounding the case that could call the "versions of liberalism" hypothesis into question. The following discussion will be organised around the "access points" for neo-mercantilist influence identified in Chapter 3.

Several US high-level executives made comments on the EC's handling of the merger case after the DoJ had closed its investigation and it became clear that the EC would reach a different conclusion. President George W. Bush stated that "we brought up the proposed merger at the appropriate levels" and that "I am concerned that the Europeans have rejected it" (CNN 2001b). What Bush considered "the appropriate levels" went beyond competition officials and included a meeting between the US Ambassador to the EU and Mario Monti, where the former, according to DG Competition respondents, talked about the negative effects the case could have on the transatlantic trade relationship. It was followed up by criticism from US Trade Representative Robert Zoellick, US Commerce Secretary Don Evans, and then US Treasury Secretary Paul O'Neill. The latter used the most colourful language, calling the EC finding "off the wall" and describing the Commission as "the closest thing you can find to an autocratic organization that can successfully impose their will on things that one would think are outside their scope of attention" (BBC 2001; Forbes 2001). From a "pure" competition policy point of view, this should have been outside the scope of attention of all the Secretaries as well.

The reactions from the executive branch were echoed by US legislators. Chairman of the Senate Aviation Subcommittee, Senator Jay Rockefeller IV stated that a European decision to block the merger could have a "chilling effect on transatlantic aerospace and aviation cooperation". In a letter to the Vice President of the European Commission, Loyola de Palacio, he further stated that if the EC were found to unfairly block mergers, "then the Subcommittee will need to re-examine the open market the US has maintained for those sorts of acquisitions" (CNN 2001d). Other Senators from both parties followed up with similar statements.

Neo-mercantilist motives could also come from the political appointment of top officials at the DoJ. The clearest example is William Kolasky, Deputy Assistant Attorney General with special responsibility for international antitrust, who consulted Honeywell with respect to the EC's review of the case before he took office. EC officials strongly suggested in interviews that this, as well as the inauguration of a new Administration that was perceived to be less concerned with antitrust, influenced the US decision. When looking closer at the timing, however, the picture changes.

Although Bush took office in January 2001, the key Antitrust Division executives were appointed after the staff had performed the analysis and made its recommendation to clear the merger. The new administration accepted everything and made the final decision without any changes. Moreover, the political comments quoted above were made after the DoJ had closed its case and approved the merger.

In the EU, there were not many instances that could be interpreted as neo-mercantilist. Except for the strong backing from the Advisory Committee on the EC position, which is in no way uncommon, EU Member States seem to have played no role in the proceedings. In particular, France and Great Britain did not express any special concerns, which should have been expected were they to protect Thales and RR, respectively. Also, DG Competition met no resistance from other DGs, neither in the inter-service consultations or in the final vote by the College of Commissioners, which reached its decision unanimously. This could of course have been due to the fact that DG Competition wanted to block the merger and that there was no need to interfere to protect “European interests”. Still, had the merger been a clear-cut approval case, one should expect more tension to arise, at least some opposition from MTF technocrats who, as discussed in Chapter 2, want to do the “right thing” and from Member States who would benefit from lower prices.

The DG Competition took the objections raised by competitors into account. They were, however, advanced as much by US firms like P&W, Rockwell Collins and Hamilton Sundstrand as by RR and Thales. Indeed, according to the Economist (2001), “in the end it was mainly American companies, not Europeans, that furnished him [Monti] with the information that was used to justify blocking the deal”. The two largest customers, Boeing and Airbus, both endorsed the merger (CNN 2001c). From a neo-mercantilist point of view, one should have expected the “European champion” Airbus to go against it in order to protect other European firms as well as to avoid that Boeing would get an advantage from lower GE/Honeywell prices, if Airbus were to purchase future engines and avionics and non-avionics systems from Thales and RR only.

A last factor speaking against the claim that the EC had neo-mercantilist motives for blocking the merger comes from the other side of the Atlantic: None of the

DoJ competition officials interviewed by the author found any reason to believe that the EC decision had been influenced by neo-mercantilist concerns. The validity of these statements are increased by the fact that several of the officials criticised the EC approach fiercely and thought that non-economic factors had played a significant role in the BMDD case.

6.4 Conclusion

The analysis has shown that there were significant differences between the EC and the DoJ approach to the merger. The question then becomes how they could be explained and to what extent they were systematic. The first hypothesis of this thesis is concerned with different versions of liberalism: one that focuses on efficiency and consumer surplus; and one that cares more about maintaining competition as such. This distinction proves very useful in understanding the outcomes.

Both the EC and the DoJ claimed that they had made their decisions according to neo-liberal economics. At this point, it could thus be instructive to revisit the seven requirements set by the OECD for finding portfolio effects detrimental to competition (see Section 2.2.5). The EC was satisfied that all were met, the DoJ was not:

- *The merged firm could offer lower prices post-merger.* The US agreed. The EC failed to estimate the size of the price reductions, however;
- *Rivals cannot match lower costs.* The US claimed that competitors would respond by cutting costs, improving products or engaging in counter-bundles;
- *Rivals will exit.* The US regarded this as highly speculative and indeed unlikely;
- *Buyers have no countervailing powers.* The US had particular “belief” in the reactions of Boeing and Airbus, which, moreover, were positive to the merger;
- *Firms cannot re-enter after exit.* The high degree of innovation and other barriers make it likely that re-entry would not be timely, likely, nor sufficient;
- *The merged firm finds it profitable to raise prices above pre-merger levels.* The EC made the argument, but made no effort to estimate the likely monopoly price; and
- *What buyers gain in the short term is less than what they lose through paying higher than pre-merger prices in the longer term.* The EC never estimated the size

and duration of the initial price cuts and subsequent increase. Hence, it could not make the appropriate trade-off between short- and long-term effects.

In light of the answers to the OECD requirements, it does not seem like the EC proved to a sufficient extent that the merger would be detrimental to consumer welfare, as required in the neo-liberal paradigm. If the question were whether a joint GE/Honeywell would strengthen its position on the relevant markets, the answer is clearer: Bundling does benefit a firm at the cost of its competitors.

Hence, it appears like the DoJ had greater confidence in the self-regulatory capacity of the market, which sets the focus on the first bullet point: The merger would produce lower prices to the benefit of *consumers*. The EC, on the other hand, believed that it was necessary for the government to intervene to protect consumers *and* competitors.

As should be expected from the “versions of liberalism” hypothesis, the competition authorities also disagreed on how to treat possible *efficiency gains*. In addition to the Cournot effect, the DoJ was also open for gains stemming from management reforms and capital. As the facts are not entirely conclusive, it is difficult to assess whether the EC refusal to consider these factors amounted to an efficiency offence. The effect from better management could be (close to) zero, and even the US asserted that the capital market is such that all firms would have readily access to financing. There is less neo-liberal support for the EC claim that “enormous financial means” would foreclose competitors to the detriment of consumers. Ordo-liberals would, however, share the latter concern: Large resources could be used to gain power as well as work as a *barrier to entry*.

The “versions of liberalism” hypothesis also focuses on *ex ante* versus *ex post* regulation and different *time perspectives*. The EC was so concerned about the long term effects of the merger that it found it necessary to block the merger *ex ante*. The US claimed that it too was concerned with long term effects (Kolasky 2001:25); from its assessment of the case, it is evident that it was at least *less* concerned than what the EC was. Its argument that possible anti-competitive effects, were they to materialise, should be dealt with *ex post*, points in the same direction (ibid.).

In conclusion, the analysis shows that first hypothesis (H_1) on different versions of liberalism, seems to have good explanatory power. The DoJ decision was taken in close accordance with neo-liberalism as presented in Chapter 2. The agency considered the merger to be *pro*-competitive and increase consumer surplus as it would give GE/Honeywell “the ability and incentive to offer customers lower prices and better products, that meant that the merger should benefit customers both directly – through the lower prices and better products offered by the firm – and indirectly – by inducing rivals to respond with their own lower prices and product improvements” (DoJ 2002:226-7). The EC also claimed that its concern was with customers and consumers. Although this may be true, it seems clear that it rested on a different kind of dynamics, with a goal of maintaining competition and protecting rival firms over the longer run, even if short term increases in consumer surplus would have to be sacrificed. This is exactly the approach that Ordo-liberalism would prescribe.

The second hypothesis (H_2) on neo-mercantilism trumping some version of liberalism gets only weak support. Firstly, although some of the case characteristics were conducive to an economic nationalism approach, the main shortcoming was that there were no “champions” to protect. Secondly, the EC argument lacked a firm theoretical base. The underlying logic was, however, not unreasonable when considered in the light of a version of economics focussing on dominance and maintenance of competition. Interviews with several DoJ officials helped shedding light on the US clearance, making up for the lack of official publications. Lastly, there was not much “circumstantial evidence” to back a neo-mercantilism hypothesis. The reactions from US executives and legislators could be seen, from a liberal point of view, as inappropriate, but with the discrepancy in timing between the Antitrust Division’s analysis and the appointment of its executives, it is unlikely to have influenced the decision. Moreover, the EC upheld its conclusion from the May Statement of Objections to prohibit the merger in its Final Decision, independent of the political uproar in between.

Chapter 7. Conclusion

This concluding chapter will have three parts. Firstly, the research question that was presented in Chapter 1 will be revisited in light of the analyses undertaken in Chapter 3 and in particular in Chapters 5 and 6. Secondly, the usefulness of the theoretical and methodological framework as such will be discussed. Lastly, the focus will change from the past to the future and some thoughts will be offered on how and in what direction research could fruitfully proceed from the work that has been undertaken in this thesis.

7.1 *The Research Question and its (Tentative) Answer*

Within a coherent liberal politico-economic paradigm, outcomes of merger reviews should in principle not differ between jurisdictions that scrutinise the same case. Sometimes, however, they do. In this thesis, the question was asked of *why*. Two strands of explanations were offered for how outcomes are reached. They part on the issue of whether competition policy has *de facto* autonomy from societal interference. The first strand argues that it *has*, which makes technocrats in the competition agencies the central premise-setters. It was then asserted that the technocrats are guided by some version of liberalism when making decisions. Different outcomes would thus be due to the application of different liberal ideas; this was the first hypothesis. The second strand of explanation took as its starting point that competition policy is not autonomous. Rather, as any other issue, it is subject to battle between different interest-groups. In merger reviews, the main groups of actors were identified to be state departments and agencies, politicians, and the politically appointed leaders of the competition agencies. The international dimension of the mergers would, it was argued, activate a concern for national security, wealth, and competitiveness – subsumed under the heading of neo-mercantilism. If this description of how decisions are made applies to at least one jurisdiction, it will offer an alternative explanation for why outcomes diverge (the second hypothesis).

In Chapter 3, the US and EU competition regimes were discussed. The competition agencies were shown to have a substantial degree of autonomy through

their institutional build-up and legal competence. The US regime appears to be in close accordance with neo-liberal prescriptions; in the EU regime, elements of both neo- and Ordo-liberalism seem to be incorporated. Several points were identified, however, through which interest-groups can access the merger review process. Hence, no unambiguous conclusions could be drawn from this discussion, leaving it for the case studies to decide why outcomes differ between the two jurisdictions.

Two merger cases were scrutinized in detail: the Boeing/McDonnell Douglas deal and the attempt of GE and Honeywell to join forces. The analyses proceeded in two steps. First, the decisions as set out by the competition agencies were examined. This was done according to the procedures used by the US and the EU and with weight on their evaluation of five liberal factors that are seen as crucial for what outcome is reached (see Section 2.2.6). Second, the cases were analysed in relation to neo-mercantilism, extending the scope to encompass the whole merger process.

Both cases offered (some) support to the first hypothesis. As expected, the US decisions were largely in accordance with neo-liberal ideas: The theories of harm were applied and evaluated with their effects on consumer welfare in mind; efficiency gains were appraised positively and were neither seen as barriers for potential entrants nor as forcing actual competitors to exit the market. They were only considered indirectly, however, as the FTC and the DoJ did not find either of the mergers to create anticompetitive problems. The EC, on the other hand, paid some attention to how the mergers would affect competitors. Efficiency gains were, moreover, disregarded or viewed with scepticism: They would raise the barriers to entry further in industries that were already extremely difficult to access, and competitors could be outdone and forced to leave the market. This was explicit in the case of the GE/Honeywell merger attempt, whereas the conclusions from the BMDD merger were less definite.

The last two of the five liberal factors, time perspectives and ex ante/ex post regulation, were also more relevant and thus clearly displayed in the GE/Honeywell case. The EC worried about the long-term effects of possible bundling arrangements as well as the leveraging of GE's strength to Honeywell. It therefore decided to block the merger before any harm could be done. The US saw the deal creating, if anything, short-term gains, and let it pass.

The application of different versions of liberalism thus seems to explain a significant share of the divergence underlying the different outcomes. In the GE/Honeywell case, it can account for all the variance; in the BMDD merger, some aspects can not be explained by it. What about the second hypothesis, then?

Politicians and state agents got involved in both merger cases, but there was a difference in the intensity of the pressure. Moreover, in the GE/Honeywell case, the interest-groups seemed only to reach other external agents and the media, not the decision-making process inside the competition agencies. In the BMDD merger, on the other hand, the external groups dictated the outcome on some issues and set limits for what the competition authorities were allowed to decide on others. Why was there a difference between the cases? Two (non-excluding) explanations can be offered: Firstly, the BMDD merger was a better case for neo-mercantilism than the GE/Honeywell deal. Most importantly, the US saw it primarily as a defence merger and would simply not allow the transaction to be blocked. In addition, the civil side of the merger displayed a “tidier” division of interests across the Atlantic than what the GE/Honeywell case did: Each side had a national champion to protect in a “winner-takes-all” industry with thousands of jobs at stake. Secondly, it is possible that the properties of the competition regimes as such have changed in the time between the mergers. In particular, the continuous interaction between the competition agencies may, along the lines of Majone’s argument, have made them more determined to resist political interference (see also Section 7.3).

On a more general level and going beyond the two case studies, the analyses demonstrate the need to question the claims made by the competition authorities that all decisions are made within a neo-liberal framework. This is the answer to the critical test outlined in Section 2.4.1. The empirical evidence presented in this thesis suggests that competition policy is relatively autonomous from societal interference, with small but significant variations in the interpretation of liberal ideas accounting for most of the divergence between the jurisdictions. Some cases, however, are “too important” to be left to the market; defence is one of them, which set a limit to the outcomes that could be reached in the BMDD case. Before broader generalisations can be made, however, more cases must be analysed.

7.2 *Assessing the Framework*

As competition policy has been undertheorised from a political economy perspective, much of the effort of constructing the analytical framework was devoted to developing concepts, categories, operationalisations, and, to a modest extent, theory. How fruitful has this undertaking been in light of the empirical analyses?

In general, the framework seems to have picked up the central aspects that lead to an outcome: the content and logic of the decision as set down by the competition authorities as well as the surrounding processes. Taking autonomy as the point of departure gives rise to two distinct analytical paths that facilitate the examination of both the decision and the surroundings. The framework excludes no actor, idea or interest *a priori*. As such, it could be applied to different policy areas, where the particular characteristics of the issue at hand would determine who and what to include. In the context of merger review, two choices were made: The range of ideas available to the competition authorities was limited to neo- and Ordo-liberalism; the external pressure-groups were reduced to politicians and state agencies with neo-mercantilist interests. In addition, the management of the competition authorities was considered explicitly while the involved firms were seen as influencing outcomes only indirectly through other actors. How fair were these assumptions?

In analysing a decision, five liberal factors were singled out as central for explaining divergent outcomes. Not all are equally relevant or brought into play in all cases, but they seem to catch the most important aspects. The discussion of the US and EU competition regimes (Chapter 3) supports the selection of factors. Neo- and Ordo-liberalism take different stands on each of them, which gives a good opportunity to distinguish between the theories. It is of course possible that other versions of liberalism could have been chosen in addition to or instead of the ones selected here; it is not obvious to the author which versions this should have been and what value this more complicated framework would have added, however.

The focus on some external actors means that others are neglected. An argument for the selection of politicians and state departments and agencies, and the assertion that they would have interests given from a neo-mercantilist way of thinking, was given in Chapter 2. The case studies seem to support the decisions. No other

group of actors was particularly involved in the process and no other interests were voiced, to the knowledge of the author, explicitly or implicitly that influenced the outcome. The exception is of course the merging firms, their competitors, as well as suppliers and buyers. They do not seem to have played an independent and direct role, however. In the BMDD case, for example, Boeing requested the help of the US government, which may or may not have gotten involved had the request not been made. The latter argued along the lines expected from neo-mercantilism and faced the same kind of argumentation from politicians on the other side of the Atlantic. The firms as such had access to the competition authorities throughout the merger review process without achieving tangible results. The case only changed character after these other actors got fully and heavily involved.

The main problem with the framework is that it fails to yield unambiguous answers, i.e., multiple causation may lead to “overdetermination”. This was realised already in the discussion of the five “liberal” factors in Section 2.2.6, where neo-mercantilism was shown to overlap the versions of liberalism on some of the factors. The problem arises because all outcomes are justified in the language of liberalism. There may also be instances where two theories prescribe the same outcome but for different reasons. In practice, this was most evident in the BMDD merger. The outcomes on the horizontal aspect of the case could, with at least some degree of fairness, be termed neo-liberal, Ordo-liberal, and neo-mercantilist. There was also a more general overlap between neo-mercantilism and either of the two versions of liberalism on other parts of the case. This may appear discouraging to the prospects of finding conclusive answers to why disagreement occurs. There are, to the author at least, no obvious ways around this problem as long as all outcomes are framed in liberal terms, and the issues they concern are too sensitive for the actors involved to speak completely freely about their motives and actions. This is at least the case as long as one wants to remain true to the empirical material and not develop a framework only for the purposes of methodological clarity. Although the latter would, by design, produce unambiguous results, they would hardly be valid if they ignored central elements of what is going on “out there”.

7.3 Where to go from here

The analytical framework that has been developed in this thesis could potentially be used as a starting point for further research in several areas. Firstly, it could be applied to other policy issues that, in a liberal politico-economic paradigm, should be given autonomy along the lines discussed in Section 2.2.1. One example, in which substantial work has already been undertaken, is credit market regulation (see Tranøy 2000). Secondly, merger review is only one of several issues included in the term competition policy. Outcomes in, e.g., monopoly, vertical agreements, or predatory pricing cases could be usefully examined both within and across jurisdictions. This work could then take advantage of the analysis of the US and EU competition regimes undertaken in Chapter 3. Lastly, two complementary paths could be fruitfully pursued to increase the understanding of merger review processes. The first would be to analyse more cases. Including some mergers in which the US and the EU have agreed would meet any criticism arising from selecting on the dependent variable head on; examining some that have taken place in other industries as well as between two European firms or one EU and one US firm would correct a bias that has been present here. In addition, more structured comparisons could be made across *cases* in attempts to identify what can be seen as “critical factors” for explaining divergence and across *time* to see whether and how ideas and interests change and manifest in outcomes. These extensions bring the attention to and facilitate a second path of research development, which focuses on theoretical and methodological refinement. Above, the framework applied in this thesis was shown to have some weaknesses. Although no specific suggestions were made on how to improve it, this is not to say that it cannot, or *should* not, be continuously clarified and developed to encompass explanations of ever finer grain. Establishing a more valid and reliable theoretical and methodological framework may also clear the ground for quantitative studies. They have the advantage of being able to handle a much higher number of units than what is possible within a case-oriented approach, thus facilitating broader generalisations.

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